98-84375-29

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Brief and reply brief submitted on behalf of...

[New York?]

[1914]

98-84375-29
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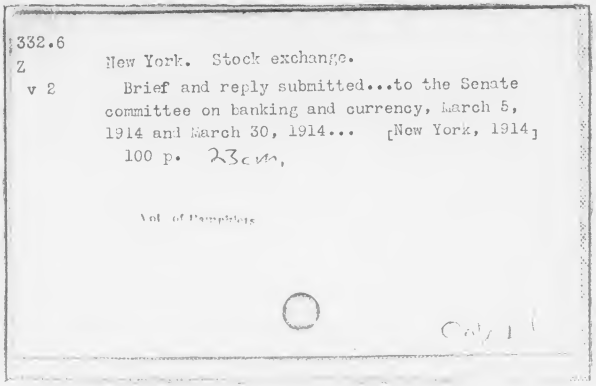

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FILM SIZE: 35MM REDUCTION RATIO: 11:1 IMAGE PLACEMENT: IA (IIA) IB IIB

DATE FILMED: 3-31-98 INITIALS: CB

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BRIEF AND REPLY BRIEF

SUBMITTED ON BEHALF OF THE

NEW YORK STOCK EXCHANGE

TO THE

Senate Committee
on Banking and Currency

MARCH 5, 1914, AND MARCH 30, 1914, RESPECTIVELY

With the Compliments of the
New York Stock Exchange

New York Stock Exchange

The New York Stock Exchange takes pleasure in handing you herewith a pamphlet which it trusts will receive your careful attention. In it you will find a clear explanation of the attitude taken by the Stock Exchange, at the hearings before the Committee on Banking and Currency of the United States Senate, toward the provisions of the Bill affecting Stock Exchanges introduced in the Senate by Senator Owen.

In the latter portion of the pamphlet you will find a brief reply refuting arguments and statements made in behalf of the Bill.

Committee on Library

Before the Committee on Banking and Currency

OF THE UNITED STATES SENATE.

In the Matter
of
Senate Bill 3895 entitled a bill "To prevent the use of the mails and of the telegraph and the telephone in furtherance of fraudulent and harmful transactions on stock exchanges."

BRIEF ON BEHALF OF THE NEW YORK STOCK EXCHANGE.

Introduction.

We have discussed in a separate brief the constitutionality of this bill. We propose to discuss the bill as a practical measure in this brief, assuming for that purpose, but for that purpose only, that Congress may, under its power to regulate the mails and the interstate business of telegraph and telephone companies, compel the Stock Exchange, within some defined limits, to observe certain requirements as a condition to the transmission of its quotations through the mails and by telegraph or telephone. To justify such a bill it should appear that there is a definite evil to cure, and that the bill is an appropriate and efficacious remedy. These are the

concrete questions we propose to discuss; and the task is one that truth and justice require shall be executed in a spirit of fairness and candor. That is the spirit in which we undertake it.

What is the evil alleged as the reason for the bill? In the report of the Committee appointed pursuant to House Resolutions 429 and 504 to investigate the concentration of control of money and credit, dated February 28, 1913, (which we shall hereafter take the liberty of calling, for brevity, the Pujo Report) this is what is said on that subject (p. 116):

> "But whether stock exchanges in their wholly local and internal relations may be regulated by Congress or not where they lend their facilities for transactions injurious to the public interests at large Congress may prevent any instrumentality under its control from being used to multiply and spread such transactions; and it is its obvious duty to do so. It has appeared that sales of stocks on the New York Stock Exchange average $15,500,000,000 annually; that but a small part of these transactions is of an investment character; that whilst another part represents wholesome speculation a far greater part represents speculation indistinguishable in effect from wagering and more hurtful than lotteries or gambling at the race track or the roulette table because practiced on a vastly wider scale and withdrawing from productive industry vastly more capital; that as an adjunct of such speculation quotations of securities are manipulated without regard to real values, and false appearances of demand or supply are created, and this not only without hindrance from, but with the approval of, the authorities of the Exchange provided only the transactions are not purely fictitious. In other words the facilities of the New York Stock Exchange are employed largely for transactions producing moral and economic waste and corruption; and it is fair to assume that in lesser and varying degree this is true or may come to be true of other institutions throughout the country similarly organized and conducted."

This would be a grave indictment of a great institution, whose membership is representative of the best citizenship

of New York, if there was any foundation for it, which happily there is not.

If this statement stood alone we would assume that the bill was framed to correct the evil thus alleged to exist; but in another part of the report we find the following (pp. 114, 115):

> "Great and much needed reforms in the organization and methods of our corporations may be legitimately worked out through the power wielded by the Stock Exchange over the listing of securities. Much of the confusion and many of the defects in corporate regulation due to the diversity of State laws and to the bidding of the States against one another in laxity of administration in order to attract corporations within their borders may be corrected and uniformity of methods introduced through the listing department of the Exchange. Thus complete publicity as to all the affairs of a corporation may be uniformly enforced. The scandalous practices of officers and directors in speculating upon inside and advance information as to the action of their corporations may be curtailed if not stopped. In short its opportunities as an agency of corporate reform are almost endless provided its own practices can be reformed so as to entitle it to exercise these broad powers."

This is quite a different reason for the bill. The evil here specified is the impotency of government under our political system properly and adequately to regulate corporations; and the cure proposed is that the New York Stock Exchange shall be constituted the effective agency of corporate regulation. This means that the National Government may employ the Exchange to correct the shortcomings of the State governments in the regulation of corporations and the reform of corporate abuses; but, it is added, that the Exchange itself must be reformed that it may efficiently perform this function of government. This proposition is as startling as it is novel. It invests the Exchange with powers and functions that have never been within its contemplation, and the assertion of which would have subjected it to the accusation of an un-

bridled arrogance. The question naturally arises, how much of the bill is based on the evils alleged to exist in the transactions of the Exchange, and how much on this programme of corporate regulation and reform. That line will have to be drawn as we proceed.

The natural order of the topics to be discussed is, in the first place, whether the alleged evils exist, and if so to what extent; and in the next place whether, and to what extent, the bill is a practical remedy for any evils that may be found to exist. The data to be examined in determining these questions are the statements that have been made and documents submitted at the hearings held by this Committee; the evidence taken by the House Committee that investigated the so-called money trust, and the Pujo Report; common knowledge; and the bill itself. It is to be borne in mind, so far as the testimony taken by the House Committee is concerned, that the Committee was represented by its own counsel; that it selected the witnesses it desired to hear, though in some instances, so far as the Stock Exchange was concerned, after a conference with its counsel; that it selected the topics respecting which it desired testimony; that the examination of witnesses was conducted solely by its counsel and was often in the nature of a cross-examination; that the sole right of counsel for a witness was to frame any question he might desire to ask and submit it to the Committee for approval so that it might be put by the counsel for the Committee if approved; and that many questions were asked that could not be adequately or satisfactorily answered on the spot without opportunity for previous preparation or reflection. This is not said by way of criticism, but merely to call attention to the fact that the investigation was essentially *ex-parte*. Moreover we feel bound to say that the officials of the Exchange felt throughout that there was a deep and controlling prejudice against it, reflected in the tenor of the examination of many of the witnesses; in the

bringing in of topics calculated to create prejudice which were not germane to the inquiry, and which were afterwards discarded in the conclusions of the report for that reason; in the treatment of such topics in the report though concededly not germane; and in the bias of the report which ignores the case of the Exchange on almost every point. Had the investigation been broadened out to give the Exchange an opportunity to present its case in its own way, as it has presented it to this Committee, which would only have taken a few days, though the report might not for reasons have been different, the record would have been a more complete, reliable and useful presentation of the facts.

The questions we propose to discuss are, (1) Is it true that, while a small part of the transactions on the Exchange are of an investment character, and another part represents wholesome speculation, a far greater part represents speculation indistinguishable in effects from the worst form of gambling? (2) Is it true that there is manipulation of securities on a large scale without regard to real value; and that this manipulation proceeds not only without hindrance from the authorities of the Exchange but with their approval, provided only that the transactions are not fictitious? (3) Is it true that the facilities of the Exchange are largely employed for transactions producing economic waste through withdrawals or diversions of capital from productive industry and other commercial purposes.

Having discussed these questions we shall then be in a position to take up the remedies of the bill to determine to what extent they are necessary, practical and germane.

I.

The nature of the transactions on the Exchange.

(1) There are listed on the Exchange 565 issues of stock with a par value of $13,385,447,500 and 1089 issues of bonds with a par value of $12,589,577,100. They are issues made in the main by railroad, industrial and mining corporations; but there are some issues of municipal bonds, domestic and foreign. The Exchange is the principal market in this country for the purchase and sale of these securities, and in the volume of its business is second only to the London Exchange. It is also an international market of considerable magnitude. The transactions originate in orders to buy or sell from all parts of the country and from foreign countries. No one can say what proportion of those transactions is of an investment nature, because no clear line can be drawn between what is investment and what is speculation. Many who buy for investment buy partly on credit; and purchase for investment may have in it a speculative element determining the permanence of the investment. It is a common experience to buy for investment and yet sell on an unexpected rise in the market or when an expected rise takes place. It is not a criterion of the investment or speculative character of a transaction whether or not the security is bought partly on credit any more than it is in the case of purchases of real estate. Securities bought with a speculative purpose may be retained as investments. Any statement of the proportion of the transactions that are of an investment as distinguished from a speculative character is merely a worthless guess. There have been numerous efforts in the past by foreign economists to establish that proportion

on foreign exchanges, which has been discarded and the effort abandoned as futile.

(2) There is a very large volume of speculative transactions characterized in the Pujo reports as "wholesome" speculation. "Wholesome" speculation we take to be speculation by persons who have the means or credit to carry their transactions through and who buy and sell intelligently in the expectation of a rise in price in the one case or a fall in the other. This is admitted on all sides to be perfectly legitimate, and it is just as legitimate to sell in the expectation of a fall in price as to buy in the expectation of a rise. No one can measure the extent or proportion of the transactions on the Exchange of this character; but they are unquestionably of great magnitude and a considerable proportion of the whole. What value would be attached by any sensible man to any estimate of the number of men of means and intelligence in this country who speculate in securities to some extent or of the volume of their transactions of that character?

(3) Another large class of transactions on the Exchange consists of the buying and selling of stocks by or for the dealers in lots less than the Exchange's unit of one hundred shares, or, as they are called, odd lots. We refer to the statement of Mr. Noble on this point, where it appears that he is a dealer in odd lots; that there are many houses engaged in the same kind of business; that this business in small lots is about twenty per cent. of each day's business of the Exchange in normal times; and that the bulk of it is investment business (R., pp. 160-178).

(4) There is a considerable body of men on the Exchange known as floor traders, who daily buy and sell large volumes of active stocks in the expectation of a slight profit being realized during the day. Another similar class, known as arbitrageurs, is composed of brokers here and abroad who buy and sell for a profit with reference to differences in

prices on this and foreign exchanges. An arbitrageur buys or sells a security listed on both the London and New York Stock Exchanges during the hours that the London Exchange is open, and buys or sells it as the case may be during the hours that the New York Stock Exchange is open on the same day. The business of the floor trader is legitimate speculation, and is an important element in providing a continuous market. The arbitrage business is of considerable volume, and is not only legitimate, but has a distinct value, recognized by economists, in assisting the adjustment of international dealings.

Mr. Sturgis estimated that these dealings of floor traders and arbitrageurs on their own account were one-third of the total dealings on the Exchange (Pujo Test., p. 826).

(5) The only remaining element is speculation by those who should not speculate because without either the means or the intelligence to do so, properly called unwholesome speculation. The volume of this sort of speculation on the Exchange has been constantly diminishing. It is business that the broker avoids because of the risks it involves in rapid changes of price and the doubtful ability of his customer to meet his obligations. The Exchange prevents it to the utmost limit of its powers. What remains of it is to some extent due to ignorance of the broker of the real circumstances of his customer, either through misrepresentation or neglect to make proper inquiries. There is no doubt, however, that the volume of the transactions of that character is enormously exaggerated not only in the popular mind but by serious and thoughtful people. It is so easy for a defaulter to attribute his fall to speculation that all such cases, as well as the losses in bucket shops, and the losses through all the swindling schemes in connection with mining and other stocks, not listed or dealt in on the exchange, with which the country is flooded, are widely attributed to the exchanges. But the truth is that the volume of this unwholesome speculation is, compared with the vast mass of transactions that take place on the Exchange every day, too inconsiderable to be classified as a feature of any moment or influence on prices.

It is true that the Hughes Commission said in its report that " it is unquestionable that only a small part of the transactions upon the Exchange is of an investment character ; a substantial part may be characterized as virtually gambling ". But this statement is not a conclusion from any verifiable data. Though it may voice a popular impression it is not in accord with the judgment of the men intimately connected with the affairs of the Exchange. Not only is the volume of the investment business in their judgment much larger than is indicated, but the term gambling is not appropriately applied to any substantial body of transactions on the Exchange, unless all speculation, whether in securities or commodities or in any other department of human activity, is to be regarded as gambling, which is not an accepted use of the term either in the domain of law, business or economics. Wagering or gambling in connection with transactions in securities is well known to the law and has been defined with precision ; and as so defined it does not include what is known in business affairs or economics as speculation. Speculation is one thing and gambling another, and no useful purpose is served by characterizing one as the other. When important issues are under discussion affecting great and vital interests language should be used with some degree of precision, and not figuratively.

(6) The foregoing is merely descriptive of the daily transactions on the Exchange. It is what anyone would see if he had eyes enough to perceive all the transaction that take place on any day. He would see purchases for investment ; he would see sales on behalf of persons wishing to convert their securities for one purpose or another ; he would see purchases and sales for the dealers in odd lots to meet the needs

of the small investor; he would see purchases and sales for customers with a purely speculative purpose; he would see the floor trader buying and selling for the profit of the hour; he would see the arbitrageur selling securities that he has bought in London, or Paris, or Amsterdam, or Berlin, the same day, or buying here the securities he has sold on a foreign exchange the same day. Every transaction is recorded and the quotations that go out are the result of all of these manifold operations. They are the product of the judgments, temperaments, hopes, fears and doubts of the vast multitude that participate in them. It is a scene of competition; the conservatism of investment face to face with the enterprise of speculation; speculation in the expectation of a rise in prices with speculation in the expectation of a fall; optimism with pessimism; and the resultant of this play of forces is the market price of the securities dealt in moment by moment, hour by hour. The Exchange is the crucible in which all these various elements are, as it were, chemically combined and concentrated to produce what we call market values. All these elements are indispensable as supplements and correctives of each other. Eliminate speculation and the conservatism of investment would arrest the development of the country. Eliminate speculation in the expectation of a fall in prices and the danger of inflation of prices would be constant. Without the free interplay of all these forces a market would not perform its function of fixing values for the purposes of trade and commerce. To say that the swift, ceaseless stream of transactions in such a market as the Exchange is, or can be, polluted in its main body is to our minds absurd. But the fundamental contention of the Pujo Report is, that it is so polluted by what is called unwholesome speculation and manipulation; hence this bill. Whether there is any basis of fact for that contention we now proceed to examine, because if there is not, that might well be treated as the end of the matter without going further.

II.

Unwholesome Speculation.

(1) An entire subdivision of the Pujo Report is devoted to this subject (pp. 42–46). There is no attempt there to define the characteristics of unwholesome speculation as contrasted with any other kind of speculation. Attention is called to certain tables and charts that had been prepared for the Committee, showing the dealings on the Exchange in the shares of various corporations month by month since 1906, and day by day during the most active months. The corporations selected were the United States Steel Corporation, the Reading Company, the Erie Railroad Company, the Rock Island Company, the Consolidated Gas Company, the Union Pacific Railroad Company, the Columbia and Hocking Coal and Iron Company, the American Can Company, the American Smelting and Refining Company, the Amalgamated Copper Company, the Colorado Fuel and Iron Company, the Brooklyn Rapid Transit Company, the California Petroleum Company and the Mexican Petroleum Company. This was certainly an artful selection for the purpose. It was a grouping of the most speculative and active stocks on the Exchange during the period covered by the tables and charts, not to show normal or average conditions, but for the dramatic effect of a combination of extremes. Had tables been prepared to show normal or average conditions it would have appeared that the total of the dealings was just about the amount of the total par value of the listed securities. We are not criticising the propriety of the selection for the purpose of showing extensive speculation in particular stocks; but merely guarding against the inference that it is a normal condition with the numerous stocks actively dealt in on the Exchange. If, instead of copper companies, petroleum companies and industrial companies there had been included in the

list such companies as Chicago and Northwestern, the Chicago, Milwaukee and St. Paul, the Pennsylvania, the New York Central, the Northern Pacific, the Great Northern, the Louisville and Nashville and the American Telephone and Telegraph Company, the result would have been a more instructive presentation of actual conditions.

It is not necessary to state in detail what these tables and charts show. It is enough to say in a general way that they show dealings in the course of a month or a year in the stocks of the companies selected of great magnitude, the total listed stock of some of the companies having been sold many times over in the course of a year, and sometimes more than once in the course of a month. The tables are condensed on page 44 of the Pujo Report, to which we refer for the details

(2) The important question is what conclusion is to be drawn from these tables and charts. They show extensive speculation concentrated in certain popular, active and speculative stocks such as is taking place on every stock exchange or bourse in the world. The speculator does not select slow moving, inactive stocks in which the dealings are mainly for investment. He picks the stocks that are conspicuous ; that are dealt in to such an extent as to have a constant and wide market so that he can buy whenever he wants to buy and sell whenever he wants to sell ; and which respond quickly to all the varying conditions of business and affairs. Such stocks are the natural centre of speculation. Moreover they are the stocks in which the floor trader and the arbitrageur mainly deal, and the volume of their dealings is always heavy in active times. Mr. Van Antwerp's statement covers this situation quite fully (R., pp. 130, 131). These are the facts that explain the great volume of dealings shown by these tables and charts, and which will occur just as long as there are markets and speculation. What the tables and charts prove is speculation and nothing

more. They do not establish that the speculation was "unwholesome", whatever that may mean. There was no evidence showing that it was speculation by unintelligent people of inadequate means and credit, or for an illegitimate or improper purpose. As long as there is speculation it will occur, in its most active and vigorous form, in connection with such stocks, and therefore the tables and charts demonstrate no more than that there is constant and active speculation in stocks of the character selected involving a constant and rapid passing of the same shares or certificates from one person to another. The necessary consequence of speculation is that the same shares or certificates pass rapidly from one ownership to another in the constant buying and selling that goes on, and without any transfer on the books of the company. Hence the fact that the total dealings appear to be many times the total of the capital stock of a company in a limited period of time is the inevitable result of speculation in and of itself, and no indication whatsoever of an unwholesome or illegitimate form of speculation.

(3) Speculation is necessary, useful and legitimate. We need not elaborate this proposition in view of the statements made by Mr. Conant, Professor Emery, Mr. Page and Mr. Van Antwerp. Their presentation of the matter was not disputed by any one. It is scientifically treated in the writings of economists everywhere, and its legitimacy and vast usefulness demonstrated. John Stuart Mill in his writings says that "Speculators have a highly useful office in the economy of society;" and Leroy—Beaulieu, the great French economist, says that "the evils which speculation prevents are much greater than those it causes." That many engage in it who should not do so because of lack of means or intelligence is indisputable ; but that does not affect the fact that it is a legitimate process. As long as human nature remains as it is the unfit will en-

gage in speculation to their detriment no matter what precautions are taken. As we have said in another place:

> "The matter may be put in this way. The right to buy and sell securities is just as much an inherent right as the right to buy and sell any other commodity. This right can be exercised unwisely and recklessly; but there is no way of providing by law or rule that a right may be exercised wisely but may not be exercised unwisely. The possession of the right carries with it the possibility of its unwise exercise."

So far as the effect of illegitimate, as distinguished from unwholesome, speculation upon prices is concerned, if they are separable things, which there is nothing in the Pujo report to indicate, the remark of President Hadley in his work on Economics that "the illegitimate speculations deal with the same articles as the legitimate ones" has an important bearing, because it shows that whatever there may be in the way of illegitimate speculation however defined with respect to a stock or security or any other article is being corrected all the time by the legitimate speculation in the same stock, security or article. To conclude what we have to say on this subject we again insist that the tables and charts under discussion simply show speculation, and contribute no evidence whatsoever to support the assertion that it was unwholesome or illegitimate speculation.

III.

Manipulation.

(1) The term manipulation is one of comparatively recent origin. Like all such terms it is necessary to define it to avoid confusion in its discussion. We get nowhere if it has different meanings to different minds. It has been so much

used of late that it should have a definite meaning and application; but that is far from the truth. It has, for instance, been applied argumentatively before this Committee to transactions to which it does not at all apply. It is also improperly confused with speculation. It is not easy to say what the meaning commonly attributed to it is, because it is generally used as a term of vituperation rather than as description of a definite class of transactions. Perhaps as accurate a definition as can be given of it is, the giving by the same man or group of men of contemporaneous, or practically contemporaneous, orders to various brokers to buy, and to other brokers to sell the same security at the market price whatever it may be, from time to time, for the purpose of realizing a speculative profit, in some cases from an expected or intended rise in the price and in other cases from an expected or intended fall in the price, the vice of such a system of orders being that their execution may not involve a change of ownership.

Let us now analyze various classes of transactions to determine whether or not they are manipulation within this definition.

(a) Contemporaneous orders may be given to different brokers, emanating from the same man or group of men, for the sale of a stock at a fixed price and on a scale up, and for the purchase of the same stock at a lower fixed price and on a scale down. It is clear that the brokers with such orders to sell on the one hand and to buy on the other can never treat or deal with each other under these orders, because under these circumstances the sales by the brokers having the orders to sell must be to outsiders and the sales to the men with orders to buy must be made by outsiders. There may be various objects or purposes for such a system of orders; for instance to steady the market in times of excitement when the bankers behind an issue of stock feel a responsibility with respect to its going unwarrantably high

or unwarrantably low to the injury of investors; or to steady the market price of a new issue; or to furnish a market to anyone who has acquired the stock and desires to sell or to any one who desires to buy. It is for those purposes a perfectly legitimate operation and not manipulation in any sense. This is clearly shown by the testimony of Mr. Henry in the case of the California Petroleum Company, who, notwithstanding strenuous efforts of counsel to show that such a proceeding was manipulation, conclusively established that it was not. (Pujo R., pp. 1282-1287). Transactions of this character are not therefore manipulation.

(*b*) Another class of transactions consisted of contemporaneous orders given by the same man or group of men to various brokers to buy a stock "at the market", and to another set of brokers to sell "at the market." The two sets of brokers being on the floor at the same time the result might be that they would trade with each other, and if they did no real change of ownership occurred, though the transactions between the brokers were actual transactions, and the brokers themselves were ignorant that the same principals were behind all of them. By the transactions being actual in such cases we mean that in every case there was a purchase and sale consummated, as distinguished from a mere matching of orders or "washing" of transactions.

A resort to such transactions in good faith to draw attention to a new stock on the basis of its real value was approved by the Hughes Commission, which said, with reference to it, that this

> "kind of manipulation has certain advantages, and when not accompanied by 'matched orders' is unobjectionable *per se*. It is essential to the organization and carrying through of important enterprises, such as large corporations, that the organizers should be able to raise the money necessary to complete them. This can be done only by the sale of securities. Large blocks of securities, such as are frequently issued by railroad and other companies, cannot be sold over the counter or directly to the ultimate investor, whose confidence in them can, as a rule, be only gradually established. They must, therefore, if sold at all, be disposed of to some syndicate, who will in turn pass them on to middlemen or speculators, until, in the course of time, they find their way into the boxes of investors. But prudent investors are not likely to be induced to buy securities which are not regularly quoted on some exchange, and which they cannot sell, or on which they cannot borrow money at their pleasure. If the securities are really good and bids and offers *bona fide*, open to all sellers and buyers, the operation is harmless. It is merely a method of bringing new investments into public notice."

Whether this is a sound view or not, it was at any rate the view generally accepted as sound and correct not only on the Exchange, but outside of it; and, indeed, it is only recently that it has been questioned. But as such transactions might be resorted to for purely speculative purposes, they have presented a difficult problem. The attitude of the Exchange formerly was, that if the transactions were actual, in every case being consummated by payment and delivery, and free from collusion, they were legitimate. This is the purport of the testimony of Mr. Sturgis before the Pujo Committee, which is so severely criticised in its report (pp. 46-47). Mr. Sturgis was simply defining what the attitude of the Exchange had been. The suggestion that he laid stress in his testimony on the payment of the commission of the brokers, as if that were the sole interest of the Exchange, is quite unwarranted because it is clear that he only mentioned the payment of the commission because it was evidence bearing on the actuality of the transactions. In recent times there has arisen a conflict of opinion on this subject, and the Governors of the Exchange have taken advanced ground by prohibiting such transactions altogether. The resolution of February 5th, 1913, hereinafter set forth, is explicit on this point in prohibiting all transactions that do not involve a change of ownership.

But there remains the question, what substantial evidence

is there that there was ever any considerable body of transactions on the Exchange of that character. We may be sure that if there was any such body of transactions they would have been elaborately and exhaustively exploited by counsel before the Pujo Committee. With his large practice, extending back many years, and the knowledge that it must have given him of what was taking place in the world of enterprise, business and finance, and his wide acquaintance with men prominent and active in affairs, it is reasonable to assume that no past operations in securities on a large scale calculated to attract attention by their character and results escaped his knowledge or were not ascertainable by him. It is fair to say that the instances he did bring forward are all that he could produce, with all the sources of information at his command, with any show of establishing his case against the Exchange. Had the Exchange been the scene for years and years of predatory movements in stocks on a large or small scale, the record of the Money Trust investigation would show the fact conclusively; and it is no escape from the meagerness of the record in this regard to say that the instances given were "typical." It is too favorite a device of the advocate seeking to establish a general condition to insist that the particular instances he produces are "typical" to accept such a statement as a substitute for actual evidence. These particular instances must therefore be treated as the only transactions that could be produced with sufficient definiteness to constitute proof or evidence.

(2) These instances are the Columbus and Hocking Coal and Iron pools, the Rock Island "episode" of December 27, 1909, and the California Petroleum Company matter, which are discussed on pages 47–52 of the Pujo Report. We will take them up in their order:

(a) The Columbus and Hocking Coal and Iron Company Pools.

The Columbus and Hocking Coal and Iron Company owned property consisting of over 13,000 acres of land in Athens, Hocking, Perry and Vinton Counties, Ohio; 250 acres of mineral leaseholds; 4 blast furnaces with a capacity of 70,000 tons annually; 14 active coal mines with an annual capacity of 2,000,000 tons; and various town lots, stores and dwelling houses. It had also valuable clay deposits on its lands and did a thriving business in bricks and paving blocks. Not long prior to March, 1909, oil in paying quantities had been discovered on the property (Poor's Manual, 1909). There were about 70,000 shares of its common stock listed on the Exchange (Pujo Test., p. 701). The company had a bonded debt of $1,260,000, $500,000 preferred stock and $7,000,000 common stock. In March, 1909, a so-called pool was formed to acquire 20,000 shares of the stock. Later another pool was formed to buy 20,000 additional shares. Lathrop, Haskins & Co. and James R. Keene were the principal holders in both pools, and associated with them were various banking and brokerage houses.

A pool in and of itself is simply a joint venture of various individuals, managed by some individual or firm selected for that purpose. It has always been asserted by the members of these pools that they were formed in the belief that the enterprise was bound to be successful in a degree that would make its stock very valuable. At the time the first pool was formed the stock was inactive and selling at about 20. Through the transactions on behalf of these pools in the acquisition of the stock it rose in price until in the first week of May, 1909, it was selling at 65¼. It rose to 90 by November 13th, 1909, and remained in that vicinity until the third week of January, 1910. On January 19th, 1910, through a large amount of stock being unexpectedly thrown on the market, and the inability of the active men in the pools to provide sufficient capital to sustain the market, the stock collapsed; the price fell rapidly from 88 to 25; and three of the participating firms failed.

The transactions of the pools in acquiring their holdings consisted of buying and selling orders at prices fixed by their manager and the brokerage house in direct charge of the matter for him, given to a large number of brokers, among whom there was no collusion, each transaction being actually carried out. These transactions were resorted to because the pools being the buyers in the market their purchases would have rapidly carried the stock to an inordinate price unless there had been also selling orders. The testimony of Mr. Popper shows that these buying and selling orders were given at specific and limited prices (Pujo Test., p. 906). In the case of Mr. Criss, who is what is called a specialist and as such was the only broker who had both orders to buy and sell, it appears that his orders were to sell on a scale up and to buy on a scale down (*Idem*, 911). That is, in outline, the transaction.

The report of the Pujo Committee is very severe in its animadversions on the Exchange respecting this matter. On page 49 it said:

> "That the authorities of the exchange were aware of this operation while it was in progress is shown by the fact that the firm most prominently engaged in it on the floor of the exchange was 'twice cautioned' by the president at the request of the law committee (Sturgis, R., 845). Having this knowledge it would have been an easy matter for the law committee and the governing committee under their power to inquire into the dealings of members and to make examinations of their books (Const., Art. XI., subd. 9; Art. XVII., sec. 7), to discover all those engaged in the operation and stop it. The accountant for the receiver in bankruptcy of one of the failed firms, with more limited facilities for examination, was able to uncover the 'wash sales' and other manipulative transactions and the brokers who executed them (Morse, R., 714-716). More remarkable even than the neglect of the authorities of the exchange to stop this operation when they knew it was going on was the theory on which they inflicted punishment after the pool collapsed. Of the 9 or 10 firms engaged in the pool, only the ones that failed were punished. They were expelled from the exchange. The others were neither expelled nor suspended, but merely 'censured.'

> Thus the punishment was inflicted, not for the character of the operations, since all were equally culpable in that regard, but for becoming insolvent in consequence of dealing beyond one's means."

Mr. Sturgis did say in his testimony that the firm most prominently engaged, which was the firm of Lathrop, Haskins & Company, had been twice cautioned by the president of the Stock Exchange, Mr. R. H. Thomas. Had Mr. Thomas been called as a witness, it would have appeared that as early as May 10th, 1909, he, together with Mr. Ely, the Secretary of the Exchange, had inquired into the matter; and that they had Mr. Haskins before them, who expressed a firm belief in the future of the Company, and informed them that they had been large holders of the stock for some years; that all stories of a "corner" or of a large short interest were absolutely untrue; that there was no large buying demand; that part of the holdings of 13,000 acres of the Company had been leased to an oil operating company whose wells were all producing, some as high as 250 barrels a day; that developments in the adjoining lands made it appear certain that the Company's lands would produce large quantities of high grade crude petroleum oil; that they were amply able by well-secured time loans to care for the situation, especially in case any of the stockholders were anxious to sell, giving the name of their bankers to verify that fact; that the market was perfectly legitimate; and that he and his associates were going to hold their stock because of what they believed to be its real value. It is moreover the fact that in October, 1909, the property was visited by a party of engineers and bankers who were most favorably impressed with it, and whose opinion became known to members of the Law Committee of the Exchange.

The volume of transactions in the stock on the Exchange for six months prior to January 19th, 1910, had been light, averaging about 800 shares per day. The rise in price from 20 to 65 between March, 1909, and the first week in August,

1909, and the subsequent rise from 65 at that time to 90 in November, was due to the purchases on behalf of the pools. During this time it was the outsiders who sold their stock to the pools (Horace White, R., p. 291 ; Sturgis, Pujo Test., p. 848).

The statement in the Pujo report that the accountant for the receiver in bankruptcy was able to uncover the " wash sales and other manipulative transactions " is entirely unfounded. The accountant referred to was Mr. Morse. What Mr. Morse said is shown by the following quotation from his testimony :

> " MR. UNTERMYER : Will you look at your statements there and see whether you found any wash transactions ?
>
> MR. MORSE : It is impossible to pick those out, Mr. Untermyer, from these statements. As I stated before, this work was done with the end in view of finding out who was selling the stock short, and not with the end in view of finding out what is known as wash transactions." (Morse, R., 713).

It was a pure assumption on the part of the counsel of the Committee that there were " wash transactions ", as is evident from the testimony on pages 713 and 714. Mr. Morse is an accountant by profession, not an expert in stock exchange transactions ; he had no personal knowledge of the transactions ; and all that he could state was that the books he had examined showed that there had been buying and selling orders executed, and the volume of them. Yet he is cited in the report as the authority for the existence of manipulation. What actually took place is shown in the following testimony of Mr. Popper, whose firm gave out most of the orders, to which there is no allusion in the report (*Idem.*, 906) :

> " MR. UNTERMYER : Among how many brokers did you scatter these buying and selling orders ? MR. POPPER : Twenty-five ; that is, 25 different brokers. MR. UNTERMYER : Did the buying brokers know who received the selling orders ? MR. POPPER : No, sir. MR. UNTERMYER : Nor the selling brokers know who received the buying orders ? MR. POPPER : No, sir. MR. UNTERMYER : Were your orders to buy and sell on a scale or at the market ? MR. POPPER : No, sir ; as a rule, the order came to buy, as the orders were executed, at a limited price, generally speaking. MR. UNTERMYER : Was it on a scale ? MR. POPPER : No, sir. MR. UNTERMYER : The selling orders were not on a scale ? MR. POPPER : No, sir. MR. UNTERMYER : Then the price was named ? MR. POPPER : The price was always named."

Mr. Popper did not even know that there was a pool (*Idem*, 908). Mr. Criss testified as follows (*Idem*, 911) :

> " MR. UNTERMYER : What were your orders as to buying and selling every day ? MR. CRISS : The 19th of January, which is typical, I had orders to buy 200 at 87¼ and 200 each quarter down. MR. UNTERMYER : How about selling ? MR. CRISS : To sell at 90 and every quarter up, 200. MR. UNTERMYER : Let me see if I understand. This is a typical case of each day's proceedings that you would get an order in the morning to buy how many shares ? MR. CRISS : Two hundred ; beginning at any figure, to buy 200 ; and then each quarter down, 200. MR. UNTERMYER : And then to sell ? MR. CRISS : Oh, say a couple of points higher, 200 ; and every quarter up, 200. MR. UNTERMYER : I think you said these orders all came from Haskins ? MR. CRISS : Practically all came from Haskins."

So far as the disciplinary action of the Exchange is concerned, which is commented upon so adversely, the fact is that it was perfectly proper for a number of men to associate themselves together to purchase a large block of stock ; that in doing so they at that time, violated no rule of the Exchange in giving out orders to one set of brokers to sell at a fixed price and to another set of brokers to buy at a fixed price, there being no collusion or possibility of collusion between the brokers, no broker having a knowledge of any order given to another broker, the orders all being executed in the open market, and the transactions all actually carried out and completed ; nor was it a violation of any rule

of the Exchange to give selling orders on a scale up and buying orders on a scale down. There was no basis, therefore, for the punishment of anybody in connection with those transactions as they were carried on. But these men had engaged in a transaction involving the acquisition of a large amount of stock which would necessarily raise its price, and they could only properly engage in such a transaction if they had sufficient and adequate means to sustain the market as stock was offered for sale, and thereby prevent a disastrous drop in price. It was a separate question as to each individual concerned as to whether he had the means to meet, and had met, all of his obligations connected with his participation in the enterprise. That was true in some cases and it was not true in others; and those who had not the means were punished by expulsion because they were guilty of reckless dealing in trading beyond their means. Others who had the means and met their obligations at considerable loss to themselves, were censured because of certain circumstances of relatively minor importance connected with their participation in the pools (Sturgis, R., 845–857). We submit that this statement of the actual fact shows that the attack on the authorities of the Exchange with regard to this transaction is entirely unwarranted.

(*b*) *The Rock Island "episode" of December 27, 1909.*

How this can be called an instance of manipulation is quite beyond our comprehension. It appears that a firm of brokers, by direction of a man of large means and prominent in the financial world, gave orders to twenty brokers, each to buy at the opening of the market two thousand shares of the common stock of the Rock Island Company "at the market". The purchases were made and the price of the stock rose thirty points. When they stopped the stock naturally fell to its normal price. That is all there was to the transaction. The result of it was that the parties who sold realized $640,000 more than their stock was worth at that time, and the man who bought simply

lost that amount. It was to all appearances a senseless transaction, but one absolutely free from manipulation (Horace White, R., p. 291). Until the Pujo report appeared there had never been a suggestion by anybody that the transaction involved manipulation, whatever the explanation of it may have been; and its finding that it was manipulation is one unsupported by any testimony and entirely baseless. The firm of brokers was not disciplined on any charge of manipulation. The finding of the Board of Governors against them was, that it was an act of bad judgment to give out such a mass of orders to twenty different brokers, who would all go into the market to buy at the same time, as they should have known that it would create a state of temporary confusion, excitement and demoralization. Taking into account the high standing of the firm the penalty imposed was a very severe one for an act that at the outside could only be condemned as careless or inadvertent.

(*c*) *The California Petroleum Company matter.*

There has been so much said on this subject that we shall confine ourselves to a correction of erroneous impressions concerning it conveyed by the Pujo report and by what was said about it to this Committee. With the transactions prior to the listing of the stock the Exchange had nothing whatsoever to do. The purchase of the stock by a group of bankers, the taking over of a portion of it by a syndicate, and the sale of what was so taken on behalf of the members of the Syndicate, were all matters prior to the listing and with which the Exchange had no connection. The stock was not listed to make a market for it whereby it could be sold on behalf of the syndicate to the public; nor, as is stated in the Pujo report; (p. 52), "to create an appearance of activity in the stock that would enable those to whom it had been sold to resell it to the general public at a profit." The comment in the report that "no action appears to have been taken by the Exchange as the result of this operation, in which

important banking houses, members of the Exchange, were involved," is a reflection both on the Exchange and the banking houses.

The fact is that the stock which was taken by the syndicate of a hundred or more members formed by Salomon & Co., Hallgarten & Co. and Lewisohn Brothers, composing the group of bankers who had originally acquired the stock, was all sold before the stock was listed on the Exchange. Mr. Henry testified that "every share of the stock had been sold before the stock was listed" (Pujo Test., p. 1282). Mr. Lewisohn testified (Idem, p. 923): "MR. UNTERMYER: Did you or not operate for that syndicate after selling it? MR. LEWISOHN: No sir. We sold the preferred and common and cleaned up the syndicate before it went on the Stock Exchange. MR. UNTERMYER: Then you transferred it to another syndicate? MR. LEWISOHN: No, we did not transfer it. We sold it to individual investors." The stock was dealt in on the Curb before it was listed on the Exchange, and the first price at which it sold on the Curb was about 50 (*id.*, p. 946).

The stock was listed on the 5th day of October, 1912, on an elaborate application that justified its listing. The application has been filed with this Committee. There was great eagerness to buy the stock, amounting to a state of excitement (*id.*, p. 925). Thereupon the transactions took place which are criticized. The group of bankers who had brought the stock out deemed it wise and proper, under the circumstances, to steady the market. Though they had disposed of all their holdings they felt a responsibility in connection with the stock because they had brought it out, which is the usual attitude of bankers who bring out issues of stock or bonds. The stock opened on the Exchange at 66. What the bankers did was to give to different brokers selling orders on a scale up and buying orders on a scale down. The Pujo report (p. 51) says that this was done "for the purpose, as described, of 'making a market,'" citing

Henry, R., 1282, 1283. What MR. Henry meant by this expression is shown by the next question and answer, which are: "MR. UNTERMYER: Do you mean that it was done in order to make an apparent activity in it? MR. HENRY: Not in order to make an apparent activity in it, but to have somebody there always to buy if anybody wanted to sell it and somebody there always to sell if anybody wanted to buy it" (*Id.*, p. 1282). The real object of these transactions is made clear by the extract from Mr. Henry's testimony which follows (pp. 1282, 1283):

> "MR. UNTERMYER: Do you not know, Mr. Henry, that the market operator, Lewisohn Brothers, were doing the buying and selling themselves every day? MR. HENRY: Surely. MR. UNTERMYER: In other words, they were putting in orders to buy and orders to sell? MR. HENRY: Certainly. MR. UNTERMYER: Every morning? MR. HENRY: Certainly. MR. UNTERMYER: And you were a party to that? MR. HENRY: They were acting under our general direction. MR. UNTERMYER: Every morning they would give orders to certain brokers to buy and orders to certain brokers to sell? MR. HENRY: They would put in selling orders on a scale up and buying orders on a scale down. MR. UNTERMYER: Yes. MR. HENRY: That is done to steady the price of the stock. MR. UNTERMYER: You think so? It is done to make an appearance of activity in the stock, is it not? MR. HENRY: No sir; it is done to steady the price of the stock. MR. UNTERMYER: Why should you, for instance, give orders to half a dozen brokers or more to buy a given amount of stock and orders at the same time to sell stock, with the idea that you would not at the end of the day have any stock either bought or sold? MR. HENRY: Will you let me answer that in my own way? MR. UNTERMYER: Yes. MR. HENRY: When a new stock is put on the exchange, on any great exchange like the New York Stock Exchange, there is one thing that is very necessary, and that is that its price shall be steady. When you have no active market in a stock, when you are building up an active market in a new stock, the first thing a banking house does, what it wants to do, and what it must do, whether it makes a profit or loss out of it, is to steady the price of the stock. If people come in to buy six or seven thousand

shares of stock, and there is not much around, if they do not sell the stock it will be bid away up and have a big advance. On the other hand, if somebody comes in to sell six or seven thousand shares and there are no large buying orders in there the price of the stock is going to be a great deal lower than it would be otherwise. If you put in buying orders on a scale down and selling orders on a scale up the effect of that is to steady the price of the stock. Its fluctuation is not as violent or as wide as it would be otherwise. MR. UNTERMYER: You are a believer then in manipulation, Mr. Henry? MR. HENRY: I do not know anything about manipulation. MR. UNTERMYER: Is not the process you have just described a process of manipulation? MR. HENRY: I do not think so. MR. UNTERMYER: You say you do not know anything about it? MR. HENRY: I do not think the process I have just described is what is usually termed manipulation. MR. UNTERMYER: If a banking house wants to protect a new stock, why does it not simply buy that stock from outsiders who offer it instead of trading in it by buying and selling itself? MR. HENRY: Because you cannot make only one side of a market. You have to make both sides of the market. MR. UNTERMYER: And why can it not buy that stock and sell it, when it is acquired, instead of putting in orders every day—buying orders on a scale and selling orders on a scale—for the purpose of creating an apparent activity in that stock that does not exist? MR. HENRY: It does not do anything of the kind, Mr. Untermyer. MR. UNTERMYER: Do you not know, Mr. Henry, that when you are trying to make a market for a stock in that way, by putting in buying and selling orders by different brokers for the same house, that you are creating a fictitious appearance of activity? MR. HENRY: You would be if they were at the same price. MR. UNTERMYER: But even if there is a difference of one-eighth in the price? MR. HENRY: Not an eighth. If you put in a scale of selling orders above a price and a scale of buying orders below a price, I see no manipulation about that. MR. UNTERMYER: You see no manipulation in that at all? MR. HENRY: No, sir. MR. UNTERMYER: What do you understand manipulation to be? What is your idea of manipulation? MR. HENRY: I suppose it might be defined as matching orders. MR. UNTERMYER: Do you not understand, Mr. Henry, that matching orders and manipulation are different things? MR. HENRY: I know very little about manipulation. I have no personal experience, Mr. Untermyer. MR. UNTERMYER: But that is because you do not think this is manipulation that you have been doing? MR. HENRY: I do not know what term you want to use. What we have been doing is to steady the price. It is not manipulation. * * * MR. UNTERMYER: Do you know whether you made any money in this market operation? MR. HENRY: I think we lost money in it. MR. UNTERMYER: You think you lost? MR. HENRY: Yes. MR. UNTERMYER: You expected to lose money, did you not? MR. HENRY: We did. MR. UNTERMYER: You were in it to lose money? MR. HENRY: Yes. MR. UNTERMYER: And you were willing to lose money in order to make this appearance of activity in the market? MR. HENRY: Not to make any fictitious appearance of activity. MR. UNTERMYER: You think it was real? MR. HENRY: We were willing to lose money to give the stock a real market. That is what we have done. MR. UNTERMYER: What is the difference between a real market and a fictitious market? MR. HENRY: A great deal of difference. MR. UNTERMYER: Explain it. MR. HENRY: A real market means that if a man has stock to sell he can go and sell it and find a buyer who will buy it and pay money for it, that if he wants to buy he can go and buy it and find a seller who will sell it and deliver it to him, and he will be able to give a check and become the owner of it. That is what I mean by a real market. That is what has existed in California Petroleum ever since it has been on the board."

In this discussion Mr. Henry was clearly in the right. This is confirmed by the statements made to this Committee by Mr. Van Antwerp (R., 118-120) and Mr. Noble (R., 172, 173).

That the stock has gone down in price since, for whatever the reason may be, is no evidence that there was manipulation any more than it will be evidence of manipulation if the enterprise fulfils the hopes of its promoters and the price goes up again. Many other well known and established stocks have fallen more points during the same period of time than the stock of the California Petroleum Company, with no suggestion or thought on the part of anybody of manipulation.

These being the facts, there was no occasion for punitive

action on the part of the Exchange. What was done was not a violation of any rule of the Exchange. The transactions on the Exchange were perfectly legitimate, and to adopt a rule preventing them would be not only unwise and impolitic, but a great injury to the investing public.

(3) We have now gone over all the instances constituting the case made to show widespread manipulation vitiating the quotations of the exchange to such an extent as to require radical legislation for the purification of the mails; and on which the indictment of the Exchange by the Pujo committee on this charge is based. None of them involves manipulation properly defined. There is no evidence anywhere in the Pujo record showing definite instances of manipulation. It is not necessary for us to argue that in past times there has not been manipulation consisting of contemporaneous buying and selling orders to bring about a higher level, or a lower level, of prices, or fictitious activity for purely speculative purposes. But it was always sporadic in its nature. It has practically died out with changing conditions and standards reflected in the rules of the Exchange. The transactions of the Exchange from day to day are free from it in any degree, and its quotations express the results of actual and legitimate transactions and market conditions.

IV.

The rules adopted by the Exchange to prevent manipulation and improper speculation.

(1) Rules bearing on manipulation.

(*a*) The constitution, which was adopted more than fifty years ago, contains these three provisions:

> "The Governing Committee may, by a vote of a majority of all its existing members, suspend from the Exchange for a period not exceeding one year, any member who may be adjudged guilty of any act which may be determined by said Committee to be detrimental to the interests or welfare of the Exchange" (Art. 17, § 8).
>
> "A member who shall have been adjudged, by a majority vote of all the existing members of the Governing Committee, guilty of * * * any conduct or proceeding inconsistent with just and equitable principles of trade, may be suspended or expelled as the said Committee may determine, unless some other penalty is expressly provided for such offense" (Art. 17, § 6).
>
> "Fictitious transactions are forbidden. Any member violating this rule shall be liable to suspension for a period not exceeding twelve months" (Art. 23, § 8).

This provision relating to fictitious transactions has always been construed to prohibit "matched orders", "washed sales", and all other devices the result of which is that there is an apparent but not a real transaction. There never has been a time when two men could meet on the floor of the Exchange and go through forms which were really the mere pretense of an actual transaction. The other provisions constitute the sweeping powers of the Exchange to punish any act which either impairs the reputation of the Exchange and its transactions or conflicts with absolute fair dealing. Under these provisions no member can do an act, or pursue a course of conduct, of an injurious character towards the public or a fellow member without bringing himself within the disciplinary power of the Governors, regardless of whether it is an act violative of legal rights or not.

(*b*) On December 14, 1898, the following resolution was adopted by the Board of Governors:

> "That where parties have orders to buy and orders to sell the same security, said parties must offer said security, whether it be stocks or bonds, at one-eighth per cent. higher than their bid before making transactions with themselves."

This rule prevents a broker who has both orders to sell and orders to buy from dealing with himself for both of his principals without any public offering in requiring him to first make public the price at which he is willing to buy and the price at which he is willing to sell, with an eighth difference between them, so that anyone may accept either. The effect of this is that a man cannot record as transactions dealings of his own for two principals without the opportunity to every broker desiring to buy or to sell to deal with him.

(*c*) On March 30, 1910, the following rules were adopted which, as amended May 12, 1911, read:

> "1. That the recognized quotation on stocks shall be public bids and offers on lots of 100 shares.
>
> "2. All bids and offers on larger lots shall be considered to be for any part thereof in lots of 100 shares or of multiples thereof, whether so stated in the bid or offer or not.
>
> "3. If a bid is made for a larger lot of stock above the price at which smaller lots are offered, or if a transaction is made in a larger lot above the price at which smaller lots are offered, such bidder or buyer shall be compelled to buy any or all of the smaller lots which were publicly offered at the time, at the lower price, up to the amount of the bid for the larger lot. If the bid for the larger lot is accepted, and the buyer is unwilling to buy more, the seller must give up to the members who were publicly offering to sell at the lower price, such amounts as they were publicly offering to sell at the lower price, if such claim is made immediately.
>
> "4. If an offer is made to sell a larger lot of stock below the price which is bid for smaller lots, or if a transaction is made in a larger lot below the price which is bid for smaller lots, such member offering to sell, or the seller, shall be compelled to sell any or all of the smaller lots which were publicly bid for at the time, at the higher price, up to the amount of the offer of the larger lot. If the offer of the larger lot is accepted, and the seller is unwilling to sell more, the buyer must give up to the members who are publicly bidding the higher price, such amounts as they were publicly bidding for, at the higher price, if such claim is made immediately.
>
> "5. A member may sell on offer the largest amount bid for without regard to priority of bids. Should the offer be of an amount larger than the largest bid, the balance shall go to the next largest bidder in sequence; bids for equal amounts being on a par.
>
> "A member may buy on bids under the same rule.
>
> "6. Attention is directed to the resolution of the Governing Committee adopted October 26, 1892, which reads as follows:
>
> 'When a purchase or sale is claimed by a party who states that he had on the floor a prior or better bid or offer such claim shall not be sustained if the bid or offer was not made with the publicity and frequency necessary to make the existence of such bid or offer generally known at the time of the transaction.'
>
> "7. Disputes arising from a question as to priority of bid or offer, if not settled by agreement between the members interested, shall be settled by vote of the members knowing of the transaction in question.
>
> "Disputes as to the application of rules relating to the transaction in question, if not settled by agreement between the members interested, shall be settled by any member of the Committee of Arrangements.
>
> "8. The above rules shall not apply to lots of less than 100 shares, nor to active openings when bids and offers are simultaneous."

A short explanation is necessary to make this group of rules clear. Before they were adopted it was possible for a broker to offer to buy a large quantity of shares, say ten thousand, at a price named by him, say 61, all or none, and there might be no broker having such a block of shares to sell, or only a broker there by prearrangement. But there might be a number of brokers present who were willing to sell smaller lots at that price or, say 60½ or 60. The effect of these rules is to require the man who made the bid for ten thousand shares to take any or all of the smaller offerings up to the amount of his bid, thus not only preventing any prearranged plan being carried out but furnishing a market for all the smaller lots offered. The rules have precisely the same effect with respect to a man offering to sell a large block of stock. They have proved to be most efficacious in establishing a broad and open market and preventing collusive trading.

(d) On February 5th, 1913, the following rule was adopted:

> "That no Stock Exchange member, or member of a Stock Exchange firm, shall give, or with knowledge execute, orders for the purchase or sale of securities which would involve no change of ownership.
>
> "The punishment for this offense shall be as prescribed in Section 8 of Article XXIII of the Constitution regarding fictitious transactions."

(e) On February 13, 1913, another rule was adopted, which reads as follows:

> "That reckless or unbusinesslike dealing is contrary to just and equitable principles of trade, and the offending member shall be subject to the penalties provided in Section 6 of Article XVII of the Constitution, in every case in which the offense does not come within the provisions of Section 5 of Article XVI thereof."

(f) On March 5, 1913, the following amendment to the Constitution was adopted:

> "A Committee on Business Conduct, to consist of five members.
>
> "It shall be the duty of this Committee to consider matters relating to the business conduct of members with respect to customers' accounts.
>
> "It shall also be the duty of this Committee to keep in touch with the course of prices of securities listed on the Exchange, with the view of determining when improper transactions are being resorted to.
>
> "It shall have power to examine into the dealings of any members, with respect to the above subjects, and report its findings to the Governing Committee."

It has always been a standing rule of the Stock List Committee, as a measure preventive of manipulation, to decline to list a stock unless it appeared that a sufficient quantity of it was owned by the public.

Another measure of the same kind is the rule empowering the Committee on Stock List to strike a security from the list whenever the amount outstanding has become so reduced as to make further dealings in it upon the Exchange inadvisable, and the provision of the Constitution authorizing the

Board of Governors to take similar action (Art. XXXIII., Sec. 4).

A distinct evolution is traceable in these rules which we have grouped together. From the beginning simulated transactions of all kinds have been prohibited. In 1898 this prohibition was broadened out to prevent the same broker having orders to buy and sell from dealing with himself as the representative of both principals without any public offering. Behind these special rules were the general provisions denouncing acts or conduct contrary to fair dealing or detrimental to the interests of the Exchange. These rules taken together compelled real transactions, but did not prohibit simultaneous orders to buy and sell, emanating from the same man or group of men if in their execution every transaction was real and free from collusion, and otherwise conformed to the rules, unless they involved a scheme of fraud denounced by the article of the constitution in relation to fraudulent transactions, which reads:

> "A member who shall be adjudged, by a two-thirds vote or all of the existing members of the Governing Committee, to be guilty of fraud or of fraudulent acts, shall be expelled and the President shall so declare; public announcement of the expulsion shall be made to the exchange and the membership shall be forthwith disposed of by the Committee on Admissions" (Article XVII., Section 2).

This was the situation down to 1910; and under the operation of these rules, the action of the authorities of the Exchange in enforcing them, and the changing conditions and standards of the time, manipulation consisting of concerted contemporaneous orders to raise or depress the price of a stock for speculative purposes gradually disappeared. The rules of 1910, adopted as a result of the discussion of the recommendations of the Hughes Commission, broadening the market to protect all small offers and bids in connection with an offer or bid of a large lot, were a preventive step in the same direction. Responding to the sentiment

that nothing shall be left undone to prevent such manipulation in the future the rule of February, 1913, has been adopted, assuring an actual change of ownership in every case, thereby preventing transactions of sale and transactions of purchase from being completed with shares owned by the same man or group of men. The appointment of a Committee pursuant to the rule of March 5, 1913, to watch day by day the proceedings on the Exchange and at once detect and arrest any improper practices, with power to examine into the dealings of members to ascertain their true character, is another most important step in the same direction. The preventive efficiency of this Committee cannot be exaggerated. It practically destroys the opportunity of improper practices and assures the integrity of the entire body of transactions on the Exchange. No exchange here or abroad has provided such complete and efficient machinery for that purpose.

(2) Rules bearing on speculative accounts.

Until recent years this subject was covered by the general rule, to which we have already referred, prohibiting acts detrimental to the interests or welfare of the Exchange. That rule had always been regarded as sufficiently comprehensive to reach the taking of an improper account by a member, or the carrying of it under improper conditions. In later years various specific rules have been adopted on this subject to more particularly emphasize the attitude of the Exchange. They are:

(a) On February 9, 1898, the following rule was adopted:

> "That in future the publication of an advertisement of other than a strictly legitimate business character, by a member of the Exchange, shall be deemed an act detrimental to the interest and welfare of the Exchange."

The object of this rule was to prevent advertisements by members calculated to attract the attention of the general public and have the effect of soliciting business.

Along the same line is the provision of the Constitution prohibiting the employment of agents for the solicitation of business (Art. XXXV., Section 6) and a rule adopted January 23, 1901, declaring—

> "That the employment of a clerk or clerks in a nominal position because of the business obtained by such clerk or clerks for their employer, is a violation of the rules."

(b) On May 9, 1900, the following rules were adopted:

> "FIRST. That hereafter no member of the Stock Exchange and no firm of which such member is a partner, shall establish telephonic or telegraphic wire connection between the office of such member or firm and the office of any firm or individual not a member of the Stock Exchange transacting a banking or brokerage business, unless application therefor shall first be made to the Committee of Arrangements, and shall have been approved by them.
>
> "SECOND. Every such telephonic or telegraphic wire connection which shall be so authorized by the Committee of Arrangements, as well as all existing telephonic or telegraphic wire connections of the same character, shall be registered with the Committee of Arrangements, who shall make such regulations governing the matter as they deem necessary.
>
> "THIRD. That the Committee of Arrangements shall have power, at any time, in their discretion, to order any connection of the character described in these resolutions to be discontinued."

These rules vest the control of the wire connections of a member's office in the Committee of Arrangements, made up of members of the Board of Governors, to prevent improper connections of every kind and description. They have been criticised as conferring an unjust and arbitrary power on the Governors, but it is quite plain that it is a proper and necessary power. Through its means the authorities of the Exchange know of every wire connection with a member's office, and whether or not it is an undesirable connection with

reference to the nature of the business that it would originate and bring on to the floor of the Exchange. If it is they can direct its discontinuance.

(c) On May 19, 1909, the following rule was adopted :

> "That any member of this Exchange who is interested in, or associated in business with, or whose office is connected directly or indirectly by public or private wire or other contrivance with, or who transacts any business directly or indirectly with or for any organization, firm or individual engaged in the business of dealing in differences or quotations (commonly called a "bucket shop") shall, on conviction thereof, be deemed to have committed an act or acts detrimental to the interests and welfare of this Exchange."

This rule specifically prevents any association of any kind between a member or his firm and others which might result in business being drawn to the Exchange from any person or concern engaged in transactions such as are carried on in "bucket shops."

(d) On March 30, 1910, the following rule was adopted :

> "That the taking or carrying of a speculative account, or the making of a speculative transaction in which a clerk of the Exchange or of a member of the Exchange or of a bank, trust company, banker, or insurance company is directly or indirectly interested, unless the written consent of the employer has been first obtained, shall be deemed an act detrimental to the interest and welfare of the Exchange."

This rule is self-explanatory.

(e) On February 13, 1913, the following rule was adopted :

> "That the acceptance and carrying of an account for a customer, either a member or a non-member, without proper and adequate margin may constitute an act detrimental to the interest and welfare of the Exchange, and the offending member may be proceeded against under Section 8 of Article XVII. of the Constitution."

This rule is reinforced by the duty imposed upon the Committee on Business Conduct created by the resolution of March 5, 1913 "to consider matters relating to the business conduct of members with respect to customers' accounts."

The requirement of a proper and adequate margin in connection with the accounts of customers strikes us as much more desirable than an effort to prescribe the amount of the margin. The Hughes Commission said in its report that "the amount of margin which a broker requires from a speculative buyer of stocks depends in each case on the credit of the buyer; and the amount of credit which one person may extend to another is a dangerous subject on which to legislate." Every case stands on its circumstances ; on the personality of the customer, his position, his credit and financial responsibility ; and it seems to us that a general rule requiring under the circumstances of each case a proper and adequate margin is wiser and more effective than a rule simply prescribing a definite minimum amount in all cases.

This body of rules respecting speculative accounts meets every situation that experience has developed. It is certainly comprehensive as it brings within its sweep advertising, soliciting for business, wire connections, the prohibition of dealings with classes of individuals because of the nature of their employment, and the margining of accounts of customers. There has been no suggestion of any conditions that are not covered by these rules in the Pujo Report or elsewhere. If any need for additional rules is developed the Board of Governors may be depended upon to put them in operation. There is no basis for any reasonable criticism of the attitude or regulations of the Exchange respecting speculative accounts.

(3) Section 9 of Article XI of the Constitution provides that the Law Committee "is authorized and empowered, whenever the Committee shall deem it to be for the interest of

the Exchange to examine into the dealings of any member of the Exchange."

Section 7 of Article XVII. provides as follows :

> "The Governing Committee may, by a two-thirds vote of its members present, require that a member of the Exchange shall submit to the Governing Committee or any Standing or Special Committee, for examination, such portion of his books or papers as are material and relevant to any matter under investigation by said Committee or by any Standing or Special Committee. Any member who shall refuse or neglect to comply with such requirement, or shall willfully destroy any such required evidence, or who, being duly summoned, shall refuse or neglect to appear before the Governing Committee or any Standing or Special Committee, as a witness, or refuse to testify before any such Committee, may be adjudged guilty of an act detrimental to the interest or welfare of the Exchange."

We have already called attention to the provision of the resolution of March 5, 1913, creating a Committee on Business Conduct which empowers it "to examine into the dealings of any members" with respect to any subjects referred to in the resolutions. This power is an effective agency in safeguarding the transactions on the Exchange and the rights of customers. If transactions occur which arouse suspicion complete information respecting them can at once be obtained. If a customer complains to the authorities of the Exchange of his treatment by a member they provide a summary mode of inquiry into the complaint. This power is constantly exercised for these and other purposes. There has been criticism of its exercise, or rather the lack of its exercise, in connection with cases of insolvency; but the power was not conferred to enable the authorities to keep track from day to day of the solvency of the hundreds of members who are dealing on the Exchange. It is obvious that without a corps of accountants almost as large as the active membership of the Exchange

itself it would be impossible to exercise that function, and particularly in view of the fact that the conditions that determine the solvency of an active member are fluctuating from day to day and, what is more important, the main factor is almost invariably one developed in a time of crisis. There are but few cases of insolvency, considering the large active membership of the Exchange, and the records show that they are almost entirely confined to times of abnormal conditions. There has, for instance, been only one failure in the last twenty-one months, which was not at all due to Stock Exchange transactions, but entirely to unfortunate outside investments and enterprises.

(4) We submit that this body of rules establishes care, vigilance and efficiency on the part of the governing authorities in safeguarding transactions on the Exchange. In their enforcement the disciplinary power of the Board of Governors has been rigidly exercised. There are intimations of criticism with respect to the penalties imposed in some cases, but without any presentation of the records in those cases on which the Governors acted. Having an extensive knowledge of this subject we can say without any qualification that this power has been uniformly exercised with ability, fairness and justice.

V.

The alleged diversion of bank funds and of capital from productive industry to loans in aid of speculation on the Stock Exchange.

The substance of what is said on this subject in the Pujo Report is (p. 45) that excessive and indiscriminate speculation

in stocks on the Exchange " withdraws from productive industry vast quantities of capital;" that statements compiled by accountants for the Committee, based on data obtained from 32 banks and trust companies in New York City, showed that on November 1, 1912, those institutions for themselves and their out-of-town correspondents had outstanding loans on Stock Exchange collateral amounting to $766,795,000; that of this sum $240,480,000 was loaned for the account of out-of-town banks; that though this sum of $766,795,000 represents " a substantial part of the sum *required to carry stocks bought on margin on the New York Stock Exchange*," it was not the whole amount, as it did not include amounts loaned by international banking houses and other institutions; and that at that time " money was needed for crop moving and other legitimate commercial purposes."

This presentation of the matter is not only grossly exaggerated, but in essential particulars is without any support of fact.

1. Let us first examine the statement that the sum of $766,795,000 was on November 1st, 1912, a " substantial part of the sum required to carry stocks bought on margin on the New York Stock Exchange." Was there any such sum so loaned? Whatever the true amount was, was it all loaned " to carry stocks bought on margin on the New York Stock Exchange?" Neither is the fact.

(*a*) Deducting from the total of $766,795,000 the sum of $240,480,000, being the amount given as loaned directly for account of out-of-town banks, the balance of $526,315,000 represents according to this statement the amount advanced by those New York banks and trust companies on their own account. We have from the 32 banks and trust companies referred to in the Pujo report statements showing the amounts actually loaned by them on their own account to stock brokers in New York City, whether members of the

Exchange or not, on the date mentioned, which show that the actual amount so loaned was $296,800,101. This shows that the sum of $766,795,000 given in the Pujo report as substantially " the sum required to carry stocks bought on margin on the New York Stock Exchange" is at any rate exaggerated to the extent of $229,514,899.

We have no means of ascertaining what proportion of the $240,480,000 loaned directly for the account of out-of-town banks was loaned to stock brokers, but the probabilities are that if the facts could be ascertained that sum would also be materially reduced.

No doubt this error amounting to $229,514,899 is due to the fact that the Pujo report is not a correct representation of the statements furnished by the banks and trust companies to the Committee. What the banks and trust companies were required to furnish was their loans made " on Stock Exchange and other kindred securities." Pujo Test., p. 1192. In the report these become loans " to carry stocks bought on margin on the New York Stock Exchange." We shall show before we get through that there is a great difference between the two.

On the date mentioned, November 1, 1912, the 63 banks and trust companies belonging to the New York Clearing House Association reported total loans of all kinds of $1,923,374,000. As it is customary for the New York banks to carry " securities owned" by them as loans in the weekly Bank Statement, at least $400,000,000 must be deducted from this figure, leaving $1,523,374,000 as the net amount actually loaned by these institutions to all classes of borrowers in New York and elsewhere. As most of the banks and trust companies in this list outside of the 32 referred to in the Pujo report do not engage in the business of making loans to stockbrokers, the sum of $296,800,101 shown above to have been loaned by the 32 New York banks and trust companies on their own account to stockbrokers on that day may fairly be taken as substantially the whole amount so loaned to them. Thus out of total loans

on November 1, 1912, of $1,523,374,000 the sum of $296,800,101 was loaned to stockbrokers, and $1,226,573,899 was loaned to all other classes of borrowers. Loans to stockbrokers, therefore, constituted but 19½ per cent. of the total.

Put in another way, more than $1,200,000,000 was loaned to supply the needs of the country at large as against $290,000,000 loaned to stockbrokers. That this is the normal relation of the two classes of loans is shown by another computation made as of September 24, 1913. On that date the total loans of the same 63 banks and trust companies for their own account amounted to $1,226,974,500. Of this amount the total loans to stockbrokers, according to figures supplied by the banks, were $264,383,800. The geographical distribution of the remaining loans was as follows :

Eastern States (east of the Ohio)	$617,830,800
Southern States	174,140,500
Western States	167,720,600
Foreign (Canada, etc.)	2,898,800

Our information is that this is a fairly representative statement of the amount and distribution of the loans of the New York banks and trust companies at any corresponding time within the last five years. The crop moving period begins early in September and extends to the end of the year, but the largest demand on New York for money for that purpose occurs in the early period.

There is additional light to be thrown on this subject from still another quarter. The Comptroller's call for November 26th, 1912, shows that the total loans of the national banks of the country on that day were $6,059,982,029. This is the call nearest to the date given in the Pujo report, namely, November 1, 1912. Assuming the loans to stockbrokers in the City of New York to have been substantially the same on November 26th, 1912, as they were on November 1, 1912, we have a total of

such loans by the New York banks and trust companies on their own account and made by them directly for out-of-town banks of $537,280,101. Thus the total loans to stockbrokers in New York City on that date were about 8.8 per cent. of the total loans of all the national banks of the country.

(*b*) But these loans made to stockbrokers are not to a considerable extent made "to carry stocks bought on margin on the New York Stock Exchange." Loans are being constantly made to brokers upon the security of State, municipal and railroad bonds and short-term notes, most of which are not traded in at all on the Stock Exchange. Issues of State, county and municipal bonds from all over the country, including very large issues of New York State and City bonds, are bought by New York brokers who borrow a large part of the purchase price to carry them during the interval that they are disposing of them to their customers. These dealings continually reach to a very large sum, because New York is the most important market for such securities. There are to-day such bonds to the par value of many millions of dollars in the hands of brokers that are being sold to their customers daily and which they are carrying by means of such loans.

Loans are also constantly made to brokerage houses to carry underwriting syndicates in the interval between the bringing out of the new securities and their purchase by investors. These are favorite loans with the banks, because they are short time loans and exceptionally secured.

These are merely instances of loans made on "Stock Exchange and other kindred securities" that are *not* loans made "to carry stocks bought on margin on the New York Stock Exchange."

Moreover the New York banks loan large sums of money to individuals, firms and corporations for their business purposes upon the security of "Stock Exchange and other kindred securities." Loans of this character have been very com-

mon during the last few years, and are an important factor during periods of financial stringency when merchants find it difficult to market their paper. A large number of more important mercantile borrowers have come to regard their bond holdings as a sort of secondary reserve for use when their paper is moving slowly, and the same is true of interior banks.

It is also the fact that loans of this character to a large extent are made for the purpose of investment. In confirmation we quote from the "Report on the Finances" by the Director of the Mint, bearing date of January, 1914, where it is said (p. 362):

> "The great supply of dividend-paying stocks and bonds now in the possession of the public affords a most convenient facility by means of which loans may be obtained. No doubt there is a great deal more borrowing for miscellaneous investments upon the securities of a corporation whose issues are widely distributed than there was upon the credit of the same business before it was incorporated or while the ownership was in a few hands. Perhaps it is not too much to say that in times of prosperity, when the spirit of money-making is infectious, it is difficult for the average man to keep good collateral in his own box while many inviting opportunities for investment pass by."

If the figures could be obtained whereby it could be ascertained what part of the $766,795,000 mentioned in the Pujo report consisted of loans "to carry stocks bought on margin on the New York Stock Exchange" and what part consisted of loans made on "Stock Exchange and other kindred securities" for all these other purposes we have mentioned, we have no doubt that a vastly lower figure would represent the former. There is no justification whatsoever for the assumption upon which this portion of the Pujo report is based that loans made upon "Stock Exchange and other kindred securities" by the New York banks and trust companies are made "to carry stocks bought on margin on the New York Stock Exchange."

2. It is not the fact that the loans made by the New York banks and trust companies on "Stock Exchange and other kindred securities" divert funds from "crop moving and other legitimate commercial purposes," nor do they withdraw from "productive industry vast quantities of capital." There is no better illustration of the true situation with regard to the alleged diversion of funds when high money rates prevail for call loans in New York City than during the period of financial stringency in 1907, when those rates were at their highest. The figures compiled by the United States Treasury showing the movement of money during that period are most instructive on this point. They are as follows:

Reduction in cash in National Banks, August 22 to December 3	$40,838,786
Net imports of gold, November 1 to December 31	106,403,770
Increase in deposits of public funds, August 22 to December 3	79,834,689
Increase in bank circulation, August 22 to December 3	49,856,524
Decrease in cash in State Banks and Trust Companies of New York City, August 22 to December 19	19,191,700
Total	$296,125,469

In speaking of this remarkable absorption of cash Secretary of the Treasury Cortelyou in his annual report for 1907 said:

> "Of this great absorption of currency, amounting substantially to one-tenth of the entire estimated money in circulation in the United States, more than two-thirds of the burden fell upon New York. This was almost inevitable from the fact that New York is the financial distributing center of all the country. The figures show that more than the entire net loss in National Bank reserves fell upon the National Banks of New York City. The National Banks outside of New York City, in spite of heavy demands upon them, were able by the aid of New York to maintain an amount of cash actually larger by a small amount on December 3 than they held at the date of the previous report to the Comptroller on August 22, when conditions were

still relatively tranquil. The National Banks of New York City not only met the demand for currency until their reserves were reduced $54,103,600 below the legal limit, but, in addition, they imported and distributed $95,000,000 in gold, and distributed also in order to meet the demands of their depositors and banking correspondents, all of the money of the Government deposited with them. The result was that of the $296,000,000 currency absorbed throughout the country, $218,275,304 was provided by the banks of New York City."

This would appear to be a sufficient answer to the argument that money can be kept in New York, or drawn to New York, by high rates for call loans when it is needed in other parts of the country for productive industry, crop moving or any other purpose; and the subject can be pursued further. If the fact is that in periods of unusual demand for money for crop moving or other purposes, the outflow of funds from New York vastly exceeds the inflow, the assumption of the Pujo report to the contrary fails. The year 1906 was a period of exceptional demand for money owing to the business and commercial conditions which had existed for some time, and during that period call money rates touched 40 per cent. per annum in September, 9 per cent. in October, 27 per cent. in November and 36 per cent. in December. These high rates offered such an inducement to foreign institutions to lend money in New York that approximately $400,000,000 were advanced in 1906 by London, Paris and other foreign centres to New York borrowers. This money went far to take the place of the large withdrawals of money from New York by the interior banks of the country. Between August 4, 1906, when the outflow of currency from the New York banks to the interior banks began, and November 9 when the movement ended, $41,710,000 more currency was sent to the interior banks than was received from them in New York City, taking no account of the heavy payments to the Sub-Treasury for account of

interior institutions. Thus, instead of a flow of money to New York attracted by high rates, the fact is that the flow was from New York to the interior banks that they might meet the local demands upon them.

During a similar period in the year 1905, when there was a great demand for money, the flow of currency between August 12 and December 18 shows that $21,749,000 more was sent to the interior banks by the New York banks than was received from them, in addition to the very large payments made by the New York banks to the Sub-Treasury for the account of interior banks.

During the same period in the year 1901—which was another time of great demand for money—the shipments of currency by the New York banks to the interior banks exceeded by $18,500,000 the shipments received from the interior banks, and this also was in addition to large transfers of cash to the interior banks through the Sub-Treasury.

The fact is that in all times of urgent demand for money the high rates for call money in New York draw money from abroad, and more money goes to the interior from New York than comes from the interior to New York, through currency shipments and transfers at the Sub-Treasury to meet the demands of the country at large; and there is therefore no basis for the assumption of the Pujo report of the diversion of funds needed for crop moving and other legitimate purposes to speculation on the stock market and of the withdrawal from productive industry of large amounts of capital. To this we need only add that the use of capital or bank funds in connection with speculation is just as legitimate as the other uses to which they are put, because, as has been shown to this Committee by ample authority of the highest kind, which has not been disputed by any one, speculation is necessary and essential to the development of the industries of the country and its commercial expansion.

VI.

The Bill.

If we have succeeded in establishing, as we believe we have, in the foregoing sub-divisions of this brief, that there is no volume of transactions on the Exchange, subject to condemnation as fraudulent or improper, it follows that there is no occasion for legislation under the power of Congress to regulate the mails, and this brief might stop here. But because it is claimed that there has been manipulation or so-called unwholesome speculation to some extent, we propose, under this head, to examine the bill as a remedial measure with reference to its purpose, operation and practicability.

The bill is entitled "A bill to prevent the use of the mails and of the telegraph and telephone in furtherance of fraudulent and harmful transactions on stock exchanges." Thus, according to its title, its object is limited to excluding "fraudulent and harmful transactions on stock exchanges" from the mails, telegraph and telephone. It consists of five sections.

Section 1 provides that no letter, package, circular, pamphlet, post-card or newspaper containing any information or quotations of prices concerning transactions in securities on any stock exchange, nor any papers of any kind relating to such transactions, shall be deposited in the mails, unless the exchange is incorporated and its charter or by-laws embody the requirements and prohibitions therein prescribed. Section 2 confers power upon the Postmaster General to exclude from the mails, any letter, package, circular, pamphlet, post-card or newspaper containing information or quotations of prices respecting transactions in securities on an exchange which shall not "upon evidence satisfactory to him," have conformed to the requirements specified in Section 1 or which shall "have failed to enforce" such requirements. Section 3

provides that any person who shall knowingly deposit in the mails any letter, package, circular, pamphlet, post-card or newspaper in violation of Section 1 shall be deemed guilty of a misdemeanor, and on conviction shall be fined $1,000 or imprisoned not more than two years, or both, for the first offense, and not more than five years for any subsequent offense. Section 4 provides that if any telegraph or telephone company shall knowingly transmit any order, quotations of prices or other information concerning transactions in securities on exchanges which shall not have conformed to the requirements specified in Section 1 or that shall have failed to conform to any order issued by the Postmaster General pursuant to Section 2, shall be guilty of a misdemeanor. Section 5 defines various terms used in the bill, such as "stock exchange," "securities," "manipulation of securities," "matched orders," and "washed sales."

An analysis of Section 1 shows that the requirements imposed upon the exchanges, in addition to incorporation, may be grouped under various heads according to the purposes they are designed to subserve.

Paragraphs 1 and 2 of subdivision (*a*) and subdivisions (*b*) and (*i*) are primarily regulations of corporations, and of the relations of officers and directors to their corporations, and their purpose is to accomplish certain corporate regulation or reforms through the medium of stock exchanges. Subdivision (*e*), (*f*) and (*h*) are regulations of the relations of members of an exchange to their customers. Subdivision (*g*) is a regulation affecting members of an exchange as individuals, and subdivision (*c*) is a regulation of the exchange itself concerning the removal of securities from its list. Subdivision (*d*) prohibits the manipulation of securities and is the only provision directly relating to transactions on an exchange. We propose to discuss these requirements according to this grouping to avoid repetitions.

(1) Incorporation.

This subject has been so much discussed that it is not necessary to treat it in a detailed way. It was before the Legislature of the State of New York in the spring of 1913, and was thoroughly discussed at that time at two hearings, one before the Judiciary Committee of the Senate and the Codes Committee of the Assembly sitting together, and the other before the Judiciary Committee of the Senate with members of the Codes Committee of the Assembly present. The arguments made on those occasions by the counsel for the New York Stock Exchange will be submitted to the Committee with this brief. The subject is discussed in the brief of the same counsel submitted to the Pujo Committee, a copy of which has been made a part of these proceedings (Exhibit B, Appendix). It has been elaborately argued before this Committee, and the argument on behalf of the New York Stock Exchange is found in the record at pages 347–363. The Judiciary Committee of the Senate of the Legislature of the State of New York made a report against incorporation which was sustained by the Senate by a vote of 34 to 5. The Hughes Commission was adverse to incorporation as appears from the following quotation from its report:

> "We have been strongly urged to recommend that the Exchange be incorporated in order to bring it more completely under the authority and supervision of the State and the process of the courts. Under existing conditions, being a voluntary organization, it has almost unlimited power over the conduct of its members and it can subject them to instant discipline for wrongdoing, which it could not exercise in a summary manner if it were an incorporated body. We think that such power residing in a properly chosen Committee is distinctly advantageous. The submission of such questions to the courts would involve delays and technical obstacles which would impair discipline without securing any greater measure of substantial justice. While this Committee is not entirely in accord on this point, no member is yet prepared to advocate the incorporation of the Exchange and a majority of us advise against it upon the ground that the advantages to be gained by incorporation may be accomplished by rules of the Exchange and by statutes aimed directly at the evils which need correction."

With all this material before the Committee it would seem to be sufficient in this place to confine ourselves to a summary of the points involved.

(*a*) Incorporation is not necessary to regulation.

We think it was fairly demonstrated on the oral argument that incorporation is not necessary to regulation, either State or national, within constitutional limitations.

It is said in the Pujo Report (p. 115):

> "Notwithstanding these facts, it (the Exchange) contends that it should be permitted to continue its voluntary organization with the privileges and freedom of action of a private club and should not be made subject to legislative or judicial control or supervision and that it is not amenable to Federal regulation in its use of the mails and of the telegraph and telephone in interstate commerce and in the dealings of its members with foreign countries. To this contention your Committee is unable to agree. It is incongruous that such an institution, wielding such power and equipped to perform such useful and important functions in our economic system, should be uncontrolled by law."

This is a gross exaggeration of any position ever taken by the authorities of the Exchange. It has never claimed to be on the footing of a private club. It would be absurd to make such a claim in view of the fact that it is a market place where the members deal with each other on behalf of the public as well as on their own account. To speak of it as "uncontrolled by law" is equally absurd, considering the wide scope of the legislative power with respect to transactions on the Exchange, and the relations of the Exchange and its members to the public. The bills enacted by the Legislature of the State of New York in the Session of 1913 show the exercise of that power with respect to manipulation, false representations

concerning securities, reporting or publishing fictitious transactions, discriminations by exchanges or members thereof, transactions by brokers after insolvency, hypothecation of customers' securities, trading by brokers against customers' orders, and delivery of memoranda of transactions (N. Y. Laws of 1913, Chapters 253, 475, 476, 477, 500, 592, 593). Other bills are pending before the present session of the Legislature, and the same is true in Massachusetts. Like legislation of other States was considered in Booth vs. Illinois, 184 U. S., 425; Otis vs. Parker, 187 U. S., 606; Gale-wood vs. North Carolina, 203 U. S., 551; Broadnak vs. Missouri, 219 U. S., 285. This legislative power is limited only by its constitutional limitations, and it operates with equal force upon the transactions of an exchange and the relations of its members to the public whether it is incorporated or a voluntary association. If it were ever deemed wise to place the transactions on an exchange under the direct supervision of some public authority the power to do so would be just the same with respect to an unincorporated as to an incorporated exchange. This is really a self-evident proposition. There is therefore nothing to be gained in the way of legal control or governmental regulation and supervision by incorporation; and that being true the argument for incorporation falls to the ground, because it is founded on the proposition that incorporation is necessary to those ends.

(*b*) Though nothing would be gained by incorporation it would involve serious consequences of a detrimental character. Under a legislative charter the terms of membership, and the relations of the members to the governing body of the Exchange would be subject to legislative control, whereas they are now a matter of contract. The present disciplinary power of the governing body is based on this contractual relationship. Under the contract fixing the terms of membership every member agrees to observe the rules of the Exchange and submits himself to

the jurisdiction of the Board of Governors to punish any violation of the rules by fine, suspension or expulsion, as the case may be. The most effective of these rules are couched in the broadest language to bring within their sweep, not only acts that are wrongful from a legal point of view, but acts that are inconsistent with fair dealing and in any way detrimental to the Exchange as a great market for securities. Under this contract a member charged with a violation of a rule is tried before the Board of Governors, the selected representatives of the whole membership of the Exchange, and because of this contract between the members the courts will not interfere with any exercise of the punitive powers of the Board if it appears that the written charge made against the member concerns a violation of some rule; that the member has been heard in his defense; that there is evidence to support the decision of the Governors; and that the Governors have acted in good faith. There are numerous cases to that effect. If it were permitted to a member who has been suspended or expelled to take his case into court, for a judicial determination on the evidence of the question whether he should have been punished, the delays, and the possible conflicts between the courts, looking at the matter from a strictly legal point of view and with the legal habit of mind, and the Governors looking at it from the point of view of practical men of great experience in the actual transactions of the Exchange, would inevitably impair the efficiency of the disciplinary power and debase the morale of the Exchange and its membership. This proposition would seem to be fairly self-evident too.

(*c*) Another objection to incorporation is that there would follow from it constant appeals to the legislature to amend the charter of the Exchange, to correct imaginary grievances plausibly presented and supported by personal sympathy in case of apparent hardship, requiring continual activity on its part in legislative matters to preserve the integrity and

standing of its membership. To-day its responsibility for the conduct of its members in the transaction of business on the exchange is unqualified, and public opinion can and does hold it accountable for whatever takes place. Interference by the State under a legislative charter in the province of the relations of the members to each other and to the governing body of the Exchange—which does not at all touch the relation of the Exchange or its members to the public—will divide that responsibility and fatally impair and weaken it.

It was these arguments that convinced the Legislature of the State of New York that it would be unwise for it to compel incorporation; and we believe them to be unanswerable.

(2) The group of regulations of which corporate regulation is the purpose.

Paragraphs 1 and 2 of subdivision (*a*), subdivision (*b*) and subdivision (*i*) of Section 1 require corporations having securities listed on an exchange to file with the Secretary of the Exchange (1) a sworn statement of the nature, amount and value of the tangible and other property, assets and effects of the corporation, its actual and contingent liabilities and obligations, the volume of its business and net earnings year by year for at least three years; and a like statement with respect to every subsidiary or controlled corporation in which it is interested; and (2) a copy of every contract in writing, and a description of every parol contract, affecting the authorization, issue, sale or disposition of its securities listed on the Exchange, accompanied by a full disclosure of all fees, profits, charges, commissions or compensation paid or agreed to be paid or reserved to bankers, brokers, middlemen or others in connection therewith, and of the net amount realized or to be realized therefor.

Subd. (*b*) requires every such corporation to file at least once in each year with the Postmaster-General and the Secretary of the Exchange a detailed statement of its gross receipts

and expenses, and its net earnings; and a particular statement of any and all agreements between it and any of its officers or directors, or with any partnership, association or corporation in which any officer or director is interested, and of the profits, emoluments, salaries, commissions or other compensation or benefits to accrue therefrom to such officers or directors or any partnership, association or corporation in which such officer or director is interested.

Subdivision (*i*) provides that every such corporation shall be required to amend its charter or by-laws to expressly prohibit sales and purchases of its stock or securities by its officers and directors unless they give previous written notice of such intended action to the directors for entry upon the minutes of the meeting of the board, and unless such transactions are reported to the secretary of the company within five days after they are made that they may be entered upon the minutes of the next succeeding meeting of the board.

Some of these requirements are no doubt proper and desirable but they should be provided for in legislation directly operating upon the corporation. They are measures of regulation framed under the theory that the Stock Exchange should be made an agency of corporate regulation to correct the shortcomings of State legislation. That does not seem to us to be the province of an exchange, and no stock exchange anywhere in the world that we know is utilized by the State to perform such a function. It appears from the Pujo report that this is the avowed purpose of these provisions of the bill. Can it be seriously argued that legislation with that avowed purpose is authorized under the power of Congress to regulate the mails? If Congress has any power to legislate with respect to the inventories and statements that corporations must make; the disclosure they must make respecting their issues of securities, and the profits and commissions payable in connection therewith; the disclosure they must make of contracts in which their officers and directors are directly or in-

directly interested; and the dealings of officers and directors in the securities of their corporations, it must be under the power to regulate such corporations because engaged in interstate commerce; and it would naturally be legislation directly operating upon corporations of that character. To attempt to legislate on those subjects under the power to regulate the use of the mails is incongruous to the last degree.

Another fatal objection to these provisions is that they have no direct relation to the use of the mails, and are not germane to a bill to prevent the use of the mails "in furtherance of fraudulent and harmful transactions on stock exchanges." There is no such relation between these requirements and the character of the transactions on an exchange as to warrant legislation with respect to them under the power to regulate the mails. If there is any relation at all between them it is altogether too remote as a pretext for such legislation under that power.

Another objection, of a practical rather than a legal nature, is that the Exchange has no power to enforce these requirements. All it could do would be to strike the securities of a non-complying corporation from the list so that there could be no dealings in them on the Exchange. The result of that course would be to transfer the dealings to the unregulated markets outside, because there are such markets in which dealings in securities now take place to a large extent; and the quotations of prices that would then go through the mails would emanate from news gatherers. If there are to be such requirements they should be compulsory; and they can only be compulsory when they are imposed by legislation directly operating upon the corporations themselves.

No criticism has been heard of the listing requirements of the Exchange. They are very elaborate, and there has to be strict compliance with them, passed upon and approved by a Committee composed of experts, subject to ratification by the Board of Governors. The Pujo report says (p. 115) that the

Exchange "undertakes to prescribe the form and conditions of every corporate security in which it authorizes dealings and its determination is final through its control over the listing of such securities. It reserves the right to exact minutest details of the affairs of the issuing corporation, to impose its will in the matter of the procedure by which such corporation shall declare and pay interest and dividends, and in the matter of the transfer agents and registrar, and as regards endless other details," and adds that it is very proper for it to do so. No evil existing in the method of listing securities on the Exchange, legislation regarding it would scarcely seem to be necessary even if the power to legislate existed.

(3) The group of regulations affecting the relations of members of an exchange to their customers.

Subd. (*e*) requires the prohibition of the hypothecating by a member of any security belonging to his customer for any amount in excess of the sum at the time owing such member thereon, and of any arrangement or agreement with his customer for such use. Subd. (*f*) requires the prohibition of the lending of the securities of a customer pledged with a member, and of the making of any agreement with his customer with respect thereto. Subd. (*h*) requires that no order of a customer to purchase securities shall be executed unless the member shall have received from the customer a partial payment in cash of not less than twenty per cent. of the market price of the security on the day of purchase.

The avowed purpose of these requirements is to restrain speculation. They raise the question whether Congress has the power to regulate the relations between a member of an exchange and his customer; and whether the limitation of the right of individuals to contract with each other with respect to the hypothecation of securities, the lending of securities and the amount for which credit may be extended by one to the

other is not a violation of the Fifth Amendment of the Constitution. Hypothecation, lending securities and extending credit are matters subject to the law of the State where they occur. There is for instance a law of the State of New York which regulates the hypothecation of a customer's securities which impliedly recognizes that the securities may be used by a broker with the consent of the customer in a manner prohibited by this bill. Surely the law of the State is the paramount law on those subjects; and as Congress may not directly legislate with regard to them, it is clear that it may not do so indirectly by imposing a requirement upon stock exchanges, which in turn it can only indirectly reach through the power to regulate the use of the mails.

Passing the legal aspects of these particular requirements, there is the grave question whether it is wise to endeavor to restrain speculation by legislation. We do not propose to go into that question, because it was so thoroughly covered on the hearings before this Committee. The legislation of Germany in 1896 warns us that legislative interference with speculation on stock exchanges is fraught with danger, and apt to produce just the opposite to the intended effects; and confirmatory of that experience is the experience of Congress in enacting the law of 1864 against speculation in gold which had to be repealed after it had been in force just fifteen days.

But these requirements would serve no useful purpose in any event. If the course of a stream is dammed it will overflow the surrounding country or find another channel. Orders could be executed on the Exchange by floor brokers for non-member brokers, followed by transactions off the Exchange between the latter and their customers. The present course of business relating to the hypothecation of securities, the lending of securities and the amount of the margin is supported by long established practice, and is necessary to the carrying on of the business; and it can be continued even if prohibited by

the rules of the Exchange by membership of the Exchange being confined to floor brokers as it would be.

(4) The requirements bearing on the Exchange itself and its membership.

(*a*) Subd. (*g*) provides that the members of the Exchange shall be required to keep full and accurate books of account of all their Exchange transactions, containing all the *actual names and transactions of their customers* and the serial number of all securities or certificates that have been purchased or sold by them; and that such books and all the records of the members shall be at all times open to the inspection of the Postmaster General and such persons as he may from time to time designate to make such examinations.

The unconstitutionality of this provision was sufficiently presented on the oral argument made on behalf of the Exchange (R., pp. 374-378).

We suppose that its main purpose is to enable the Postmaster General through a corps of special agents to ascertain from the books and papers of members whether or not there are grounds for the exercise of the arbitrary power conferred upon him by Section 2 of the bill. But the investing of the Postmaster General with such a power is no sufficient reason for the invasion of the privacy of the individual books of the members of the Exchange containing their transactions with their customers. If the power cannot be effectively exercised without the invasion of that privacy it may be a good reason for not conferring it; but it is no reason for such a wholesale sacrifice of individual rights or such wholesale publicity of the private affairs of the public.

The grave practical objection to this requirement is that it would drive the public to the offices of non-members and cause substantially every responsible house to retire from the Exchange. The Exchange would become nothing more than a body of floor brokers executing orders for non-member houses and receiving payment in cash. The business now done on

the Exchange would, without regulation, be carried on through non-member houses, the names of which alone would appear upon the books of the floor broker; and the names of those houses would be of no service to the Postmaster General because their books would not be accessible to public examination. The extent to which these non-member houses would continue to avail themselves through the floor brokers of the facilities of the Exchange is even doubtful. Those facilities would be so greatly curtailed that direct dealings between houses would to a large extent, and probably to an ever increasing extent, take the place of the present open trading on the floor of the Exchange. As the provisions of subdivisions (*a*), (*b*) and (*i*) would probably cause the removal from the Exchange of many of the securities now listed there because of non-compliance with them by many corporations; and the provisions of subdivisions (*e*), (*f*) and (*h*) would take many transactions off the Exchange because an obstruction to the natural and necessary course of business; and this subdivision (*g*) would remove the bulk of the present membership from the Exchange through the exposure of their private books containing their transactions with their customers, the probabilities are that the Exchange would cease to be a market of any importance whatever. The effect of the bill would, therefore, be to seriously impair the institution as to which the Pujo report says (p. 114):

> "The stock exchanges in our principal cities, and especially those in New York, Chicago, Pittsburg and Boston, are essential instrumentalities in the conduct of modern business and finance."

(*b*) Subd. (*c*) prohibits the striking of a security from the list so long as any part of the issue originally listed is outstanding, except after due notice to all security holders affected by the proposed action, and subject to review by any court of competent jurisdiction.

It should be enough to say of this provision that by no ingenuity can any connection be traced between striking a security from the list and the transmission of quotations through the mails. The effect of striking a security from the list is to prevent all dealings in it on the Exchange, and therefore there can be no quotations of any kind respecting it on the Exchange. But passing this obvious objection, the provision is certainly in strange contrast with other provisions of the bill because the removal of securities from the list is only done when in the opinion of the Exchange it is necessary to prevent fraud or manipulation.

During the Pujo investigation the Exchange, at the request of the counsel for the Committee, furnished to the Committee a complete list of all the securities which over a long period of years had been removed from the list. The reasons for the removal were shown in each instance, and in every case in which it was called upon to do so the Exchange furnished the documents upon which its action was founded. Counsel did not put this statement in evidence before the Committee. Out of all the removals only two were brought to the attention of that Committee or adversely commented upon before this Committee. We feel that Mr. Pomroy's explanation of both of those cases must have satisfied the Committee that the action of the Exchange was proper. (See also the remarks of counsel for the New York Stock Exchange on this subject, R., pp. 371–372).

(5) Regulations affecting transactions on the Exchange.

Subd. (*d*) prescribes that the manipulations of securities and of the prices and transactions therein, and all fictitious purchases and sales of securities, and what are known as "matched orders" and "washed sales," and all other dealings or transactions that are intended, or the effect of which is, to deceive or mislead the public shall be prohibited by regulations of the Exchange to be approved by the Postmaster General. In connection with this subdivision there

has to be taken subdivisions 3 and 4 of Section 5 which define "manipulations," "matched orders" and "washed sales."

These are the only provisions of the bill that have any relation at all to transactions on the Exchange with respect to which the mails, telegraph and telephone may be used. It stands alone in a sort of solitary pertinency to the subject-matter of the bill. If a bill were drawn to prohibit the transmission of quotations emanating from manipulated transactions through the mails or by telegraph or telephone it would be proper to define what manipulated transactions were. As an effort in that direction these provisions of the bill are so extreme as to be impracticable.

Nothing need be said regarding these provisions in so far as they relate to fictitious transactions, "matched orders" and "washed sales" because they have been prohibited for fifty years and are unknown on the floor of the Exchange. The definition of "manipulation" is covered by two subdivisions (3 and 4 of Sec. 5). Sub. 3 defines it as actual sales or purchases of securities by an individual alone or in combination with others for the purpose of creating a false or misleading appearance of activity, or artificially depressing or inflating the market price of a security, or attracting public attention to the security to induce its purchase or sale by others. Hence an actual purchase of stocks, received into the possession of the buyer and paid for, may be denounced as manipulation if the Postmaster General or the Board of Governors or some other authority, penetrating the mental operations of the party, discovers, or thinks there is evidence of one of the condemned purposes. This is true whether the transactions are those of a single individual or a group of men. This may be an interesting view of the matter as a psychological problem, but from a business point of view it is utterly impracticable. Motive, purpose and intent may, of course, be inferred from the acts of parties. But when those acts are consummated transactions consisting of the sale or purchase of securities, and the buyer

or seller insists that he bought or sold them because he desired to own them in the one case or to own them no longer in the other, how is it practical for the Postmaster General or the Board of Governors to impute some hidden improper motive or purpose to the transactions. The legitimacy of business on an exchange cannot be made to depend upon such considerations if there is to be that free movement of transactions which is the essence of its usefulness as a market.

By the other definition (subd. 4, § 5) manipulation consists in giving or causing to be given, or knowingly executing or causing to be executed, upon any exchange, directly or indirectly, any order for the simultaneous, or substantially simultaneous, purchase or sale of any security by or for or on behalf of the same persons or interests, whether accomplished by means of genuine or fictitious purchases or sales. This comes nearer to a proper definition of manipulation because it involves simultaneous orders to buy and sell for the same man or group of men; but it is too broad because it covers transactions of that character which are perfectly legitimate. We refer to what we have said in the discussion of manipulation under Point III. of this brief, and insist that the definition there given, and the definition which is involved in the prohibitions of the rule of the Exchange adopted February 5, 1913, and the Act of the Legislature of the State of New York (Laws of 1913, Ch. 253) are the only practical definitions because they avoid the trammeling of legitimate and proper transactions and the unnecessary curtailment of the function and usefulness of the Exchange as a market. We reiterate that there is no existing manipulation, or existing evils due to manipulation, to call for or warrant any legislation on the subject.

(6) The only remaining provision of the bill to which we deem it necessary to refer is Section 2, conferring upon the Postmaster General the extraordinary power of closing the

mails to any letter, newspaper or other written or printed statements, containing reports or quotations of prices concerning stock exchange transactions if, upon evidence satisfactory to himself obtained as he sees fit, he shall conclude that the exchange has failed to enforce the requirements prescribed by the bill. A more far-reaching power of an arbitrary nature could not be conferred upon a public official. We do not care who that official is, or how high he may be in the hierarchy of the public service, it is hostile to the principles of a free government. To quote the language of Mr. Justice BRADLEY in the case of Boyd against the United States, 116 U. S., 632,—"It may suit the purposes of despotic power; but it cannot abide the pure atmosphere of political liberty and personal freedom." That is all we care to say on this subject.

We feel that this survey and analysis of the bill warrant the conclusion that many of its provisions are not regulations of the mails, telegraph or telephone at all, and that as a whole it would be an impracticable and harmful measure.

VII.

Conclusion.

There are some matters concerning the Exchange briefly treated in the Pujo Report which we should like to discuss that the case of the Exchange might be fairly presented; but they are not germane to this bill, and we do not therefore feel warranted in doing so. We have strictly confined our attention to the bill and the questions it raises, and have gone into them somewhat fully because they radically affect the vitals of the Exchange. If this bill were to become law or any bill drawn along the same

general lines there can be no doubt that the effect upon the Exchange would be revolutionary, both with regard to the character of its membership and its scope as a market. The tendency of one set of restrictions would be to eliminate in the main from its membership the brokerage houses that serve the public; and the tendency of another set would be to curtail the scope of the market through closing its list to many future issues of securities and the probable elimination of many now on the list. These are serious considerations which may not be ignored in framing any legislation affecting the Exchange, which is a delicate piece of mechanism that can easily be thrown out of gear. It is "an essential instrumentality in the conduct of modern business and finance"; and to derange it is to derange business and finance to a degree and in ways beyond the anticipation of any man. It is the scene of vast transactions which are carried out under its rules with an extraordinary absence of friction, obstruction and loss. It was never more alert than it is now to conform its operations to the highest principles of conduct; and to protect and safeguard the public interests. There is no occasion, in our judgment, for any legislation affecting its organization, rules or methods; and to throw it into confusion will be an irremedial public injury. That inevitable consequence we have tried to make clear, actuated only by a sense of duty,

JOHN G. MILBURN,
WALTER F. TAYLOR,
Of Counsel for the New York Stock Exchange.

BEFORE THE

Committee on Banking and Currency

OF THE UNITED STATES SENATE.

IN THE MATTER OF SENATE BILL No. 3895.

REPLYING BRIEF ON BEHALF OF THE NEW YORK STOCK EXCHANGE.

BEFORE THE
COMMITTEE ON BANKING AND CURRENCY

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IN THE MATTER OF SENATE BILL NO. 3895.

REPLYING BRIEF ON BEHALF OF THE NEW YORK STOCK EXCHANGE.

At the close of the hearing before the Committee on the 12th day of February, 1914, it was understood that briefs could be submitted. Subsequently the time fixed for their filing was March 4th; and on that day our main brief was sent to Washington, followed the next day by a memorandum on the constitutionality of the bill and another on the New York Bank Note Company matter. The final print of Mr. Untermyer's brief came into my hands on the 24th day of March, 1914. In the mean time he had appeared before the Committee and made an additional argument (Record, pp. 457-520). As the argument made by him on March 10, and his brief fill more than 100 pages of the Record it is impossible to compress this reply into a few pages as I had hoped. But I shall endeavor to confine it within reasonable limits, though to do so will involve passing over many matters which invite discussion and correction. The truth is that there is little in either

argument or brief in the way of statement of fact or argument that is unassailable.

One general observation I cannot refrain from making at the outset. I protest against the vituperation of the Exchange and its members that runs all through the brief. It is full of such phrases as "the illegitimate transactions that now disgrace it" (the Exchange); "the dissemination of frauds"; "to protect the public against being victimized"; "protect the honesty of the public market against the frauds that now characterize it"; "foisted upon the public"; "confidence game"; "blind pools"; "hundreds of millions that had been annually taken from the public and dishonestly taken"; "tortuous attitude"; "pirating on the high seas"; "filched from the public"; "incredibly deplorable state of affairs"; "abuses that were being perpetrated upon the community"; "deception of the public"; "misrepresenting the issues and misleading the public"; "juggled"; "fraud and pillage"; "cards that have been stacked against you"; "fraudulent and fictitious transactions by which the public has been grossly swindled on an enormous scale"; "prey upon the country"; "the scandals of all the past years in its management"; "the same old game"; "another raid"; "flagrantly dishonest practice"; "worst form of gambling"; "carnival of exploitation"; "long continued license". All this is mere abuse to create popular prejudice, because such a mode of treating an important subject and one of the oldest institutions in the country could scarcely have been expected to influence men of the character, experience and intellectual power that compose this Committee. It is not the phraseology of sincerity; nor of candid and dispassionate analysis or criticism; nor is it entitled to any persuasive power. On the contrary it reveals a passionate, vindictive and personal antagonism. Though so much abuse is poured on the Exchange it is asserted at the end of the brief that the

author has not intended in anything he has said "*to reflect upon the integrity of the membership of the New York Stock Exchange taken in its entirety*" (R., p. 651). But the Exchange is indistinguishable from its members; its acts are their acts; its offenses are their offenses; and its management is composed of their representatives selected by the membership in its entirety. To say that the vituperation of the Exchange is not intended to reflect on the integrity of the membership as an entirety is to confess that it is a sham.

I.

The function of the Postmaster General.

Mr. Untermyer, in his argument of March 10th, said that the bill imposes upon the Postmaster General two duties, the first of which is that he shall "examine the charter and by-laws of every incorporated stock exchange whose quotations are sent through the mails." He added:

> "If the Postmaster General, upon looking at that charter, finds those regulations in it, that is the end of his duty. It is not for him to determine whether or not the Exchange is obeying or whether it is violating the provisions of that charter. That manifestly is nothing but a plain ministerial duty" (R., p. 458).

He then proceeds:

> "The second duty and right of the Postmaster General is to examine the books of the members for the purpose of determining whether or not any member is engaged in manipulating the quotations that are being carried through the mails. If he finds there has been manipulation he has no further duty with reference to it. He cannot even cancel the charter; he cannot then deny the use of the mails to the Exchange. All he can do is to get the information and pass it along to where it belongs—to the Department of Justice" (R., p. 458).

That is contrary to the view I had expressed, which was that "if the Postmaster General shall as the result of an investigation conducted in his own way decide that the Exchange, although it has incorporated and adopted this medley of requirements, *is not enforcing those requirements*, he may issue an order suspending the transmission through the mails of any letter, package, circular, pamphlet, post-card or newspaper containing an order or statement or quotation of prices, or any advices, report or information concerning transactions in securities on the Exchange" (R., p. 377). Mr. Untermyer has evidently, since his argument, given Section 2 of the bill more careful study, because in his brief he changes his position and admits that the Postmaster General is empowered to determine whether the Exchange is enforcing the statutory requirements (R., p. 610). But he still insists that the act of the Postmaster-General in this regard is purely ministerial; and that if as a result of the examination of the books of the members of the Exchange he finds fictitious and manipulated transactions he cannot stop the transmission of the quotations through the mails, or interfere with the operations of the Exchange, or do more than "furnish the evidence thus secured as a basis for prosecuting the guilty parties"; and further, that "the Exchange is not thereby interfered with in its right to continue the use of the mails for its quotations" (R., p. 610). This is just as unfounded as his first position. By Section 2 the Postmaster General is empowered, *in the event of his determining, upon evidence satisfactory to himself*, that an exchange has failed to enforce the requirements of the bill which it has adopted in conformity with the bill, to prohibit the use of the mails. There is nothing ministerial in the nature or character of that act or determination. It is a discretionary act of the widest latitude. The Postmaster General may send his special agents to examine the books of members, and treat their reports as sufficient evidence that the statutory requirements have not been enforced by the Exchange, and thereupon arbitrarily close the mails to all letters and newspapers referring to transactions or quotations on the Exchange. The effect of such action on his part is to shut the Exchange up, to stop the circulation of newspapers through the mails if they publish the quotations of the premier security market in the country, and to demoralize a vital branch of the financial business of the country. That I have characterized as a "tremendous power"; and though Mr. Untermyer belittles it as purely "ministerial", he seems to appreciate its real character, without admitting it, by suggesting an amendment on his argument that the Exchange should be entitled to a hearing (R., p. 459), and in his brief that there should be a judicial review of the action of the Postmaster General (R., p. 610). The only tenable position is that it is not a power that should be conferred upon any official.

II.

The Position of the Exchange Respecting Federal Regulation.

Mr. Untermyer says that the discussion before your Committee has forced "the virtual admission by the opponents of this bill of the necessity for some sort of a Federal regulation"; that counsel for the Exchange has suggested that a bill similar to the bill respecting lottery tickets would answer the purpose; that the suggestion of the "substitution of the Secretary of Commerce or the Commissioner of Corporations for the Postmaster General is not explained except by the fact that the Exchange is seeking to take advantage of a prejudice against delegating

any additional powers to the Postmaster General"; that the position of the Exchange is inconsistent in that it has "submitted an elaborate argument to prove that the distribution of quotations is not interstate commerce" and yet "suggests as a remedy legislation on the lines of the anti-lottery bills" (R., pp. 612, 613). The Exchange has not admitted that there is any necessity for any Federal regulation of the Exchange. On the contrary its position is and has been all through not only that there is no occasion for such regulation, but that it is not subject to Federal regulation. All that its counsel said was that the only bill that would be a legitimate exercise of the power to regulate the use of the mails with respect to the transmission of manipulated transactions or quotations would be a bill based on the lottery ticket legislation as a precedent (R., pp. 345, 382). He did not propose such a bill on behalf of the Exchange as necessary to reach any existing conditions; nor would such a bill be a regulation of the Exchange in any sense.

The Exchange approves, and always has approved, any legislation, State or National, regulating the issue of securities by corporations, and requiring publicity as to promotion profits or any other corporate operations or transactions which affect the interests of the public. National regulations of that character would necessarily be under the jurisdiction of the Interstate Commerce Commission as to railroad corporations, and the Secretary of Commerce or the Commissioner of Corporations as to industrial corporations. That is the only connection in which those authorities were mentioned by anyone that I recall. No one has suggested any delegation of power to them in lieu of the Postmaster General with respect to the mails "to take advantage of a prejudice" or at all.

There is no inconsistency in the position taken by the Exchange. It has not insisted or argued that the interstate transmission of quotations is not interstate commerce.

The Exchange is not in any way engaged in such transmission. It collects the quotations at its own expense and sells them in the City of New York to the Western Union Telegraph Company which transmits them all over the country. Not being engaged in the interstate transmission of its quotations it is immaterial to it whether that transmission is interstate commerce or not. What was argued on its behalf was that the transactions of purchase and sale on the Exchange, which is the business that is done there, are not interstate commerce; and for that position there is the explicit authority of the United States Supreme Court (People *ex rel.* Hatch vs. Reardon, 204 U. S., 152). Hence those transactions are not subject to regulation under the commerce clause of the Constitution. But that position is quite consistent with the position that it may be within the power of Congress to enact legislation respecting the interstate transmission of false or fictitious quotations similar to the legislation respecting the transmission of lottery tickets.

III.

The proposed bill of the Boston Chamber of Commerce.

I gather from the record that the gentlemen who appeared before the Committee for the Boston Chamber of Commerce were requested to embody in a bill their idea as to what would be proper regulation and submit it to the Committee. That the Boston Chamber of Commerce has done. I understand that it is a body composed of representative merchants and business men of the City of Boston. It is fair to assume that they undertook to comply with the request of the Committee in good faith, and that the bill they submitted embodies their

sincere convictions. But Mr. Untermyer loads it with abuse and imputes to them dishonorable motives. He says, "It is the most transparent 'make-believe'", and "a 'blind' under cover of which to defeat effective regulation" (R., p. 615). Thus a body of gentlemen of high standing and position, complying with a request of this Committee, is publicly charged with deception, because it would surely be deception to submit to you a bill which was a "make-believe" and a "blind" with the real purpose of defeating effective regulation. But that seems to be Mr. Untermyer's way. He describes the New York legislation of 1913 as a "blind" (R., pp. 641, 642) "intended to stand in the way of effective legislation." Referring to the rules enacted in February and March, 1913, by the Exchange to prevent manipulation, he says that the Exchange "under pretense of such rules is attempting to perpetuate the practice"; that he "can plainly see what it seeks to accomplish here by its tortuous attitude"; and that "it wants to make it appear here that manipulation is forbidden in order to defeat legislation and still to be able to insist hereafter when that peril has passed that what it is doing is not manipulation but something that it has always claimed the right to do" (R., p. 619). Thus whether it is the Boston Chamber of Commerce or the New York Stock Exchange his method is to impute base motives.

Regarding the bill proposed by the Boston Chamber of Commerce the attitude of the New York Exchange is one of opposition to its provisions on the same grounds that it has urged with respect to similar provisions contained in the bill before the Committee.

IV.

The examination of the books of members of the Exchange by the Postmaster General and such persons as he may from time to time designate.

The purposes of this provision of the bill are more clearly revealed in Mr. Untermyer's brief than they have been before. Though the bill is drawn under the postal clause of the Constitution, and it is asserted that it "attempts nothing by indirection" (p. 629), it is now boldly asserted that "*the prevention and punishment of manipulation are the chief aims of the bill*" (R., 615). It is in that aspect of the bill as one to prevent and punish manipulation that the provision respecting the examination of the books of members of the Exchange is seen in its true light. The Postmaster General is to perform the function of a detective agency. He is to provide himself with a staff of special agents to search the books of members of exchanges for evidence of manipulation to be used in criminal prosecutions. It is explicitly said that the Postmaster General is given the power "to examine the books of the members containing entries of their transactions on the Exchange (not their other business) as the only possible means of detecting such misuse, so that if such violations exist they may be dealt with by the courts upon the complaint of the Department of Justice"; and further, that if in his examination of the books of members he finds that there has been manipulation "all he can do in that event is to furnish the evidence thus secured as a basis for prosecuting the guilty parties" (R., p. 610). This is, then, according to Mr. Untermyer, the purpose and object of this inquisitorial provision.

That being the object and purpose of the provision there is no doubt about its unconstitutionality. People *ex rel.*

Reardon vs. Ferguson, 197 N. Y., 236, is an explicit authority on that point. But, disregarding its illegality, it is indefensible as a matter of policy, because it is not within the proper province of the Postmaster General to act as a specially designated appendage of the Department of Justice to gather evidence for its purposes.

But Mr. Untermyer insists over and over again that the provision is a necessary one if manipulation is to be detected and punished. If that were a valid argument there is scarcely any limit to its scope, because it would apply to every offense the most accessible evidence of which is to be found in the books and papers of individuals. I do not think that even the most radical opponent of private rights and individual liberty is willing to go to that extent. Moreover, such an examination is not necessary to the detection and punishment of manipulation. Manipulation is to-day a penal offense, and legislation may redefine and extend it from time to time. Transactions on the Exchange take place under the eyes of men and have an unusual publicity. If the offence be committed the District Attorney, with the aid of a Grand Jury, will have no difficulty in getting proof to obtain a conviction without resorting to the books and papers of the accused party or parties. It is idle to say that they cannot reach offenses unless they have access to the books of the accused party.

This is one of the most indefensible provisions of the bill, and if enacted could only have baleful consequences (R., pp. 376, 377, 561, 562).

V.

The "Publicity Department" of the Exchange.

Mr. Untermyer says in his brief (R., p. 634) :

> "The Exchange maintains a publicity department under the euphonious title of the 'Library Committee.' In the course of the hearings before your Committee there was distributed from Washington and published all over the country a canard to the effect that the President had expressed his disapproval of the Bill now under discussion. So persistent and circumstantial was the rumor that an explicit denial from the White House was considered advisable to prevent the discrediting of the legislation.
>
> "Such methods are most unfortunate. They are bound sooner or later to react against the Exchange and thus obscure the merits of the controversy, which the champions of this measure are anxious to have *impartially and impersonally discussed.*" (Italics ours).

The only construction of which this statement is susceptible is that the Exchange through its Library Committee invented and circulated a canard misrepresenting the position of the President.

Mr. Untermyer made this same statement in the brief which he left with the Committee on February 5th, 1914 (R., p. 97).

Mr. Van Antwerp, in his address to the Committee, said respecting it :

> "I am a member of the Library Committee of the New York Stock Exchange referred to. No member of that Committee directly or indirectly (nor anyone acting for them or representing them) at any time has caused to be circulated in any way, shape or form such a canard or rumor as the one here described" (R., p. 112).

After a colloqny with Mr. Untermyer he further said:

> "I should like, in view of the statement I have just made to you, Mr. Chairman, to ask Mr. Untermyer to withdraw from the record the paragraph under discussion" (R., p. 113).

Then this followed (R., pp. 113–114):

> "Mr. UNTERMYER: I should first like to make this statement: The fact is, is it not, that a circumstantial account did appear in the newspapers all over the country shortly prior to the day fixed for this hearing to the effect that the President disapproved of this legislation? I happened to reach Washington the morning that it appeared in the papers and saw it in the papers. I did not believe it was true so I called up the White House, as I felt it would have an injurious effect and would prejudge this legislation. The statement was corrected from the White House. It was stated the President had not said any such thing or intended that any such thing should be said. What he had said was that only those measures were strictly administration measures which were specifically mentioned in the platform, such as interlocking directors, holding companies, and that the Stock Exchange measure had not been specially mentioned in the platform and therefore it was not an administration measure; but he had not expressed nor implied any disapproval of the matter. Then I learned that Mr. Van Antwerp, whom I knew had been concerned in the publicity end of the Stock Exchange business, had reached Washington that afternoon, and I also learned from some newspaper men—or at least I was told he had seen some newspaper men or they had seen him—I knew Mr. Van Antwerp had been very active in the library department of the Stock Exchange for quite a long time. I do not mean to say improperly active. I do not imply anything of the kind. But he had been before he became a Governor of the Exchange, which was very recently, quite active in the publicity department of the Exchange. That is the only basis I had for the statement, and in view of Mr. Van Antwerp's statement now made I would like to withdraw it, except to the extent which I have stated."

The repetition of the statement in the brief recently filed is under these circumstances inexcusable. Any newspaper correspondent in Washington can inform the Committee of the circumstances concerning the publication of this so-called canard, and he will confirm that the Exchange had nothing whatsoever to do with it.

Every allusion in the brief to the Library Committee of the Exchange, or its so-called "Press Bureau" or "Publicity Department" is just as baseless. The Library Committee is composed of leading and representative members of the Exchange, and they are ready at any time to give an account of what they have done to counteract the campaign of misrepresentation and abuse of the Exchange which Mr. Untermyer has conducted for the past two years.

VI.

The California Petroleum Company.

The history of the California Petroleum Company and the transactions in its stock on the Exchange is again set forth in Mr. Untermyer's brief (R., p. 625), and this is the third time it appears in the Record (R., pp. 16 *et seq.*, 92, 93). After repeating this history, the brief proceeds (R., p. 626):

> "The Exchange insists that this is a legitimate transaction because it was resorted to for the purpose of 'introducing a new security.' They say the bankers had sold their stock before this was done and there was no profit for them in this operation. The facts as proven do not sustain them. True the *first* bankers' syndicate had sold its stock. But to whom? To the *second* syndicate of which Messrs. Lewisohn were the managers and the bankers were also members. The manipulation was conducted by the *second* syndicate, which bought 163,000 shares and sold 172,900 shares during the 21 days of its operations. In the same period there were 362,370 shares sold on the Exchange and an equal number of course purchased. What about the

> dear public that was 'landed' with the 199,270 shares that were not represented by the syndicate dealings, at prices ranging between $60 and $72.50 per share that subsequently declined to $16 and are now selling at $25 ?"

It is wearisome to have again to correct the misstatements contained in this paragraph. The Exchange has not insisted that the transaction was legitimate because it was resorted to for the purpose of "introducing a new security." The transactions on the Exchange were not conducted by the *second* syndicate because all the stock of the second syndicate had been sold to individual investors before the stock was listed on the Exchange. The transactions were conducted by the banking houses that had acquired the stock and sold it to the second syndicate, not for the purpose of gain to themselves, nor for the purpose of "introducing a new security," nor for the purpose of creating an "artificial activity" in the market, nor for the purpose of marketing the stock owned by the second syndicate, but to steady the market by selling orders on a scale up and buying orders on a scale down, thereby furnishing a real market, because any man who wished to sell would find a buyer and any man who wished to buy would find a seller. To repeat and repeat that the transactions on the Exchange were carried on to enable the second syndicate to unload its stock on the public right in the teeth of the testimony which Mr. Untermyer himself elicited before the Pujo Committee is intolerable. The actual facts as revealed by that testimony are fully set forth in our brief, with references to the Pujo Record (R., pp. 540–543).

VII.

The Kanawha and Michigan Railway Company matter.

In his speech of March 10th, Mr. Untermyer said, regarding this railroad :

> "The control had been acquired by the Toledo & Ohio, which was in turn controlled by the Hocking Valley, a parallel and competing line. * * * Prior to its subjugation and while it was an independent property it was *successful and of great promise*, but under this oppression it was fast losing its value. I acted for a protective committee of stockholders of representative men who decided to appeal to the courts to liberate the road from this intolerable and ruinous thralldom. Some of my clients had owned their stock fifteen or twenty years. They had bought it when it was *a promising independent property and paying dividends*, which stopped shortly after it came under control. * * * My clients, some of them, had paid over par for that stock over twenty years ago. Mr. Gould, I think, was the name of one of them, who told me at that time that this stock had cost him, with interest on his investment, about $300 a share" (R., p. 472). (Italics ours.)

His last revised statement is in his brief, where it is said that "it appears that the road had at one time been a prosperous independent property, but had, contrary to the anti-trust law, come under the control of the Hocking Valley, which was a parallel and competing line, where it remained for many years" (R., p. 648).

What are the facts? This is the history of the road as it appears in the Company's application to list its stock on the Exchange, dated November 5th, 1890 :

> "The River Division of the Ohio Central Railroad was sold under foreclosure October 22nd, 1885. The purchaser organized the Ohio & Kanawha Railroad

Company in Ohio and the Kanawha & Ohio Railroad Company in West Virginia, and consolidated them under the name of the latter April 17th, 1886. The Kanawha & Ohio Railroad went into the hands of a receiver February 19th, 1889; was sold under foreclosure March 14th, 1890, by a decree of the Circuit Court of the United States for the Southern District of Ohio, Eastern Division. Sale was duly confirmed by said Court April 7th, 1890, and the property turned over to the purchasers April 24th, 1890. The purchasers organized the Kanawha & Michigan Railway Company."

These purchasers were the old bond and stockholders (Poor's Manual, 1890, p. 1000). In February, 1891, the Railroad was leased to the Toledo & Ohio Central (Poor's Manual, 1891, p. 730), which bought a large amount of the stock at $15 a share and guaranteed the principal and interest of the bonds.

The statement that a road which had been foreclosed late in 1885, and was again in the hands of a receiver early in 1889 and sold under foreclosure in 1890, was a *prosperous independent* property prior to its lease to the Toledo & Ohio Central in 1891 would seem to require further revision.

A reference to Poor's Manual from 1890 to 1910 shows that no dividends were paid on its stock during that period of twenty years; and the history of the road prior to that time, with its foreclosures and receiverships, would indicate that no dividends had been paid prior to 1890.

The stock of the Company was listed on the Exchange on November 26th, 1890. The following are the high and low prices of the stock from 1891 to 1907 inclusive, taken from the Financial Chronicle:

	High.	Low.
1891	16¼	10
1892	14	10⅜
1893	14½	9
1894	9¾	7⅛
1895	9¾	7½
1896	8	6⅛
1897	9¾	4
1898	8	5⅞
1899	15	7¾
1900	25	10
1901	40	21
1902	50½	33⅞
1903	47½	25¼
1904	38	22½
1905	58¾	29½
1906	76	52
1907	50	30

It is difficult to see from these figures how the stock of Mr. Gould or any of the other clients of Mr. Untermyer, acquired "fifteen or twenty years" before 1910, could have cost them, with interest on their investment, "about $300 a share" (R., p. 472), or "nearly $300" (R., p. 476), or "between $200 and $300" (R., p. 648).

In 1906 or thereabouts a Committee, of which Mr. George D. Mackay was Chairman, was formed to protect the interests of the minority holders of the stock of this Company, the majority being then owned by the Hocking Valley Railroad Company. The stockholders who desired to be represented by the Committee deposited their stock with J. P. Morgan & Co. who issued to them their certificates in lieu thereof. On March 21st, 1910, the Committee issued to the minority shareholders a circular of which the following is a copy:

MINORITY STOCKHOLDERS' COMMITTEE

Kanawha & Michigan Railway

G. D. Mackay,
Chairman,
W. H. Goadby,
I. L. Ellwood.

16 Nassau Street
New York City, March 21, 1910.

To the Minority Shareholders
of the Kanawha & Michigan Railroad.

Dear Sirs:

The Hocking Valley Railroad has been sold to the Chesapeake & Ohio Railroad, and the Kanawha & Michigan Railroad to the Lake Shore and the Chesapeake & Ohio jointly.

The price paid was 120 for Hocking Valley stock and 72 for Kanawha & Michigan stock. Your Committee has been in conference with the purchasers of the Kanawha & Michigan for a fortnight past to effect a price at which a possible sale of the Minority stock of the Kanawha & Michigan Railroad might be made if the stockholders desired and thus end the friction which has for four years past made a distressing situation for all concerned in the Hocking Valley and Kanawha and Michigan merger.

On Saturday last the officials representing the purchasers made an offer to your Committee of $72 per share for a minimum of 30,000 shares of the 44,000 Kanawha & Michigan Minority stock, the same price as was paid to the Hocking Valley Railroad for the Majority stock. This price was not as high as your Committee endeavored to get, but we are in duty bound to communicate the offer to the stockholders that we represent. This price will be less 1⅓% to the Committee to repay them for services and expenses during the period of four years of the Minority Stockholders' effort to establish their claims, and the money will be paid whenever the 30,000 minimum shares are authorized to be delivered. The alternative to this offer is for any dissatisfied stockholder to continue as a minority shareholder and trust to the future to produce revenues enough from the contributions of the new owners to the business of the Railroad which will justify payments of the dividends desired.

The plans of the purchasers contemplate improvements to cost one and a half million dollars in the next two years. That this will drain the Kanawha & Michigan surplus during that time goes without saying. There is also to be considered the Railway Bill in Congress that may have a clause to prevent majority owners buying the minority stock after the Bill is signed, and there may be a continuation of the litigation in the State of Ohio.

Your Committee will continue to represent your interests so long as the stockholders representing the minority shares desired.

You are requested to make an immediate reply to this letter

giving authority to the Committee to dispose of your shares and also naming the amount of shares held by you.

Very truly yours,
George D. Mackay, Chairman,
W. H. Goadby,
I. L. Ellwood.

Under date of May 11th, 1910, Mr. Goadby, one of the members of the Committee, wrote the following letter in response to a request for information as to the situation of this stock:

Copy.

OFFICE OF W. H. GOADBY & CO.

New York, May 11, 1910.

Mr. W. W. Heaton,
Chairman of the Committee on Stock List,
New York Stock Exchange, New York.

Dear Sir:

Referring to the nine millions of Kanawha & Michigan Railway Stock listed on the New York Stock Exchange, I herewith submit to you a statement which, to my knowledge and belief is correct. Of this issue, 80,492 shares are held in the Treasury of the Lake Shore and Chesapeake & Ohio Railroads. Of this amount 35,392 of J. P. Morgan & Co.'s Kanawha & Michigan receipts were delivered through them (J. P. M. & Co.) to the above mentioned parties by the Committee of which I am a member. 1970 shares have been pledged to us. 2800 shares are owned by Mr. John U. Brookman. Mr. Brookman is so ill that his physician forbid business of any kind being submitted to him, and while therefore Mrs. Brookman and Mr. Maloney his Secretary were willing to deliver their receipts to this Company, they were, owing to Mr. Brookman's illness, unable to do so.

We understand that the Untermyer Committee are the holders of 2100 of these receipts. This would make a total of 87362 shares accounted for out of the 90,000 share issue, leaving a balance, apparently, of 2638 shares outstanding and unaccounted for, all of which is respectfully submitted.

Very truly,
(signed) W. H. GOADBY,
Member of Com.

(Enc)

The statement annexed to the letter gave at the end the following summary :

Amount of Kanawha & Michigan stock outstanding		$9,000,000
Held by L. S. & C. & O. Co.'s	80,492 shares	
Morgan receipts pledged to Committee	1,970 "	
Held by Mr. Brookman	2,800 "	
In Hands of Untermyer Committee	2,100 "	
	87,362 shares	
Not accounted for	2,638 "	

Minority stockholders who were dissatisfied with the terms offered in the above circular organized a Protective Committee represented by Mr. Untermyer as counsel, which is the Committee referred to in the above summary as the " Untermyer Committee." Litigation was begun by that Committee as stated in his brief (R., p. 648).

This was the situation when Mr. Goadby's letter of May 11th, 1910, was received, and on the showing made by that letter and the accompanying statement the Committee on Stock List struck the stock from the list. Mr. Untermyer says that " the undoubted purpose of that action was to discourage the litigants by destroying the market for their stock and rendering it unavailable as collateral " (R., p. 648). This is unqualifiedly denied. It appears from Mr. Goadby's letter and statement that were before the Committee on Stock List that at the time that action was taken 80,492 of the 90,000 shares were owned by the Lake Shore and C. & O. Railroad Companies ; that 1,970 shares were pledged to the Mackay Committee ; that 2,800 shares were owned by Mr. John Brookman, who was then too ill to deliver them ; and that about 2,100 shares were represented by Mr. Untermyer This accounted for all but 2,638 shares of the 90,000 shares listed. That state of affairs justified the action of the Committee as it conclusively appeared that there was no longer a sufficient amount of free stock outstanding in the hands of individual owners for trading in the stock on the Exchange under proper conditions. The sole purpose of striking the stock from the list was the customary precaution of the Exchange to protect the public and the Exchange from the dangers incident to so small an amount of outstanding stock.

It is singular that Mr. Untermyer is the only person who has made objection to this prudent practice of the Exchange in striking stocks from the list. It has been done for many years ; a great many securities have been so stricken off ; and the practice has been universally approved. If it was the hardship that Mr. Untermyer maintains ; if many people had been deprived of their market and had their loans on securities so stricken from the list called, the Exchange would certainly have heard of it. So far as the present generation of the officials of the Exchange is aware no such complaint has ever been received from any one save Mr. Untermyer.

I do not see that there is any relevancy in the results of the operation of the Railroad since the Lake Shore and C. & O. succeeded to its ownership in 1910 upon which Mr. Untermyer dwells (R., p. 649). With those great railroad systems as feeders of traffic entirely new conditions came into existence, which sufficiently account for its increased earning capacity.

A regrettable mistake was made by the clerical force of the Exchange in the statement that it furnished for the Pujo Committee showing that only 2,100 or 2,200 shares of stock were outstanding when the stock were stricken from the list. At the time the statement was prepared for the Committee many demands were being made upon it for statements concerning many different matters, and the clerical force of the Exchange was overworked in preparing them. The clerk who had the matter in charge evidently furnished, through some misunder-

standing or inadvertence, the amount at that time in the hands of the so-called "Untermyer Committee" as shown by the statement annexed to Mr. Goadby's letter.

VIII.

Fluctuations in the stock of the Reading Company from September, 1906, to November, 1907.

In his argument on March 10th, Mr. Untermyer endeavored to show manipulation from the price fluctuations of the Reading stock (R., pp. 487, 488, 489), stating that "in 1906 and 1907, the years in which there were 6,533,000 shares dealt in, the stock reached the high point of 156;" that within the next year it dropped to 90; that in September, 1906, it reached 156¾ and in November, 1907, fell to 90; and that the other active stocks on the Exchange did not during that time fluctuate to "that extent or anything like that" (R., p. 489).

The fact is that there were several active stocks on the list which fluctuated as much or more. For instance between the high points of 1906 and the low of 1907, Union Pacific ranged from 195⅜ to 100, a fluctuation of 95⅜ points; Canadian Pacific from 201½ to 138, a fluctuation of 63½ points; New York Central from 156¼ to 89, a fluctuation of 67¼ points; Brooklyn Rapid Transit from 94⅛ to 26¾, a fluctuation of 67⅜ points; and Missouri Pacific from 106¾ to 44⅛, a range of 62⅝ points. The fluctuations in all these and other cases were due to the fact that 1906 was a year of great expansion and activity and 1907 the year of a severe panic.

IX.

Amalgamated Copper Company.

Mr. Untermyer brought forward for the first time in his argument on March 10th, the history of the Amalgamated Copper Company as "probably the most striking illustration of manipulation in the history of the Exchange" (R., pp. 507–511; see also Brief, R., pp. 620, 621). This belated introduction of that Company in connection with manipulation prevents any adequate treatment of the subject in this reply. He gives a history of the Company, its capitalization and increases of capital and the incidents connected therewith, and the marketing of the stock increases by various individuals, which I have not the time to verify to distinguish what is fact from what is mere assertion. He winds up with the statement that an elaborate scheme of manipulation was accomplished in 1906 and 1907 through certain operations of the United Metals Selling Company in first holding back the sale of copper, thereby raising the price of copper and of the stocks of copper companies, and then later flooding the market with copper so as to depress its price and correspondingly the price of copper company stocks, including those of the Amalgamated Company (R., 508-510). The Exchange has no information on this subject of which I can avail myself; but the testimony of Mr. Wolfson, the Vice-President of the United Metals Selling Company, given before the Pujo Committee does not seem to bear out Mr. Untermyer's charge. To be able to speak more definitely Mr. Wolfson has been asked for his comments on this charge and this is his reply.

Comments on Mr. Untermyer's Statement Before the Senate Committee.

Mr. Untermyer advances the theory that there was a desire on the part of somebody to "boost" the stock market by means of holding back the sale of copper. He says: "Then a plan was de-

vised by those gentlemen to hold back production through the selling company; instead of selling it normally, to hold back the copper and lend upon it to the owners of the mines, thus creating a scarcity of copper, so that copper went up from about 13 to about 25 cents per pound." He then begins to prove it by means of figures furnished before the Pujo Investigating Committee.

Mr. Untermyer would have us believe that the price was advanced from 13 cents to 25 cents during the years 1906 and 1907. As a matter of fact, copper sold at 13 cents in October, 1904, and had a steady rise from that time until on January 1, 1906, it was selling at 18½ cents per pound, and, as everybody knows, that year was the year of the greatest expansion this country has ever witnessed and prices of all commodities rose quite naturally.

Now, let us see how Mr. Untermyer proves that copper was held back. He tells you that in July 15,000,000 pounds of copper were sold at around 18 cents. In August copper was held back by our selling 83,000,000 pounds at over 18 cents (this is equal to about three months' production). In September copper was held back by selling about 42,000,000 pounds at 19 cents or over a month's production. He tells you that in November, when the price rose to 22 cents, we held our copper back by selling over 40,000,000 pounds. It seems to me that to carry out Mr. Untermyer's idea we should have at those prices sold very little copper and waited until it was 25 cents to unload. The fact, however, as shown by these sales, is that we attempted to stem the tide of rising prices by offering copper as freely as the market would take it; and we deviated from our usual custom of only selling three months in advance by selling copper five and six months in advance. However, even these figures that Mr. Untermyer quotes are not correct, as he only gives you the figures of part of our sales. The sales as shown by the statement presented to the Pujo Committee were as follows:

May,	1906	63,000,000	pounds	@ about	18.63c.
June,	"	23,000,000	"	@ "	18.60
July,	"	20,000,000	"	@ "	18.52
August,	"	103,000,000	"	@ "	18.55
September,	"	59,000,000	"	@ "	19.17
October,	"	42,000,000	"	@ "	20.85
November,	"	52,000,000	"	@ "	22.05
December,	"	52,600,000	"	@ "	23.03
January,	1907	17,000,000	"	@ "	24.27
February,	"	29,000,000	"	@ "	25.03
March,	"	17,000,000	"	@ "	25.48
11 Months.		477,000,000	pounds.		

Mr. Untermyer only gives the figures of the sales of electrolytic copper, which comprises the major portion of our sales.

In my testimony I told Mr. Untermyer that the average production of our companies was between 30,000,000 and 40,000,000 pounds a month; say an average of 35,000,000 pounds, which

would give the total for that period of 385,000,000 pounds, and, according to Mr. Untermyer, we attempted to hold back sales of copper by selling 477,000,000 pounds, or 90,000,000 pounds more than our companies produced in the period.

Mr. Untermyer further makes the point that after March, between the months of March, 1907, and October, 1907, there was very little copper sold. He attempts to prove by that that the copper was held back for some nefarious reason. He omits, however, to state the conditions that existed then. On the 14th of March there was a violent panic in Wall Street, and buying of all kinds stopped. The condition of the United Metals Selling Company at that time was that not only had we no stock on hand, but we had commitments for delivery of copper that carried us way into June and July. Our unfilled contracts on the 1st of April were 96,000,000 pounds of copper, all at prices ranging from 20 to 25 cents. The whole industrial and financial world after that date stood aghast, and there was no demand for copper or any other commodity (See my testimony on that point on pages 731-3).

Mr. Untermyer fails to point out that if we had attempted to force the sales of copper on unwilling buyers we would have, in the course of a few weeks, tumbled the market down to perhaps 13 cents per pound, and the people who had contracts with us to take nearly 100,000,000 pounds of copper, would have stood to lose about $10,000,000, and as we guaranteed the contracts to the mining companies we not only would have bankrupted many of our customers, but also the United Metals Selling Co. Besides, there was no occasion to do it as the mining companies we represented had sold their production for the next four months and could very comfortably sit still and deliver the copper that they had sold. After that was done, the United Metals Selling Company attempted to find a market, first at one level, then at another, until finally, in October, 1907, when all the metal that had been sold earlier in the year had been consumed, the buyers were encouraged to go into the market again at about 13 cents per pound. The wisdom of this was proven by the fact that, although the country passed through the most violent panic and unsettled conditions in its history, there were no failures among the copper consumers (See my testimony, pages Nos. 737 and 738).

Mr. Untermyer further makes the statement as follows; "They were simply selling agents, and the record shows that they were loaning on 40,000,000 pounds month by month to the mining companies on that copper in order to hold it back from the market." I defy Mr. Untermyer to prove that from the record. The record merely shows how much money was paid to the mining companies, but that was merely money paid to the mining companies out of cash collected for their account. In my testimony on page No. 728 Mr. Untermyer asks: "In April, May, June and July, in these four months alone you advanced over $42,000,000, did you not?" My answer to that was: "That we paid out that much money." Then Mr. Untermyer says: "During those four months you were not selling copper, were you?" My answer to that was that we were

not making any new contracts, but were delivering. Mr. Untermyer evidently, in all his question, seemed to think that selling copper was like selling stock certificates, that the next day you delivered the copper and got your money, so that I had to explain to him that the copper was sold for future delivery and the money kept coming in all the time.

One of the statements required by Mr. Untermyer before the Pujo Committee was to show the amount of money the United Metals Selling Company borrowed during 1907. A statement was made up, which Mr. Untermyer declined to spread on the record, but is referred to in my testimony on page No. 739. This statement completely disproves Mr. Untermyer's contention that money was being borrowed by the mining companies against copper and held back from the market for some ulterior motive. The statement shows that borrowing did not begin until September, 1907, and the total borrowings of the United Metals Selling Company to the end of the year were only about $10,000,000, and that on a business of over $100,000,000 for the year 1907. This covered a period of great financial stringency and the money was needed to keep mines and smelters in operation and not throw all the labor out of employment. Any impartial person examining the record could not but draw a conclusion opposite to Mr. Untermyer.

RESUMÉ.

When copper was around 18 cents, and showed a tendency to rise, the United Metals Selling Company, representing the largest producers in the United States and Mexico, did all it possibly could, by selling as much copper as the people would take, to stem the rise, and then when the panic broke it did all it possibly could to prevent utter disaster among the customers who had bought our copper for future delivery. Further, that neither the mining companies nor the United Metals Selling Company were borrowers of money in order to keep up the price of copper; that there was no necessity for borrowing money until the Fall of 1907, when conditions were so bad that it became necessary to curtail production at the mines, and the total amount of money borrowed was less than 10 per cent. of the year's business.

This statement of Mr. Wolfson's demonstrates that Mr. Untermyer's charge that the Amalgamated Copper Company's stock was manipulated in 1906 and 1907 through the operations of the United Metals Selling Company is utterly baseless.

XI.

Manipulation.

Mr. Untermyer's tirade against the Exchange is based on his assertion (1) that manipulation is and always has been rampant on the Exchange; and (2) that in the view of the Exchange there is no manipulation if the brokers' commissions are paid, and that it treats and defends manipulation as legitimate. These are pure assertions, without any support in the facts, or anything whatsoever to sustain them either in the testimony and evidence submitted to the Pujo Committee or the information presented to this Committee.

(1) Mr. Untermyer mainly relied on three instances to establish manipulation before the Pujo Committee. They were the Columbus & Hocking Coal & Iron Pool, the Rock Island episode of December 27th, 1909, and the California Petroleum Company matter. It is true that he called them "typical"; but that is a mere subterfuge. The presumption is that with all his industry and information they were the only concrete transactions he could bring forward. Realizing that the case he sought to make by those instances had been destroyed by a correct version of them he now shifts his position. He says that the Pujo Committee presented "on the subject of the manipulation of prices" a dozen or more cases (R., p. 623), "some of them extending over a series of years"; and that they "indicate that manipulation is the rule rather than the exception" (R., p. 628). When he says this, he is referring to the tables and charts prepared for that Committee showing the dealings on the Exchange in the shares of various corporations month by month since 1906, which corporations were the United States Steel Corporation, The Reading Company, the Erie Railroad Company, the Rock Island Company, the Consolidated Gas

Company, the Union Pacific Railroad Company, the Columbus and Hocking Coal and Iron Company, the American Can Company, the American Smelting and Refining Company, the Amalgamated Copper Company, the Colorado Fuel and Iron Company, the Brooklyn Rapid Transit Company, the California Petroleum Company and the Mexican Petroleum Company. If we turn to the Pujo Report we see that those charts and tables were produced *not to show manipulation* but to show what is called "unwholesome" speculation (Pujo R., pp. 42, 43, 44). Section 14 of that report is headed "Unwholesome speculation": it is in that section that the tables and charts are brought forward and explained; and the conclusion drawn from them is that they show an "excessive and indiscriminate speculation." In the whole of that sub-division of the report there is not a word said about manipulation (Pujo R., pp. 42–46). Section 15 of the Report is headed "Manipulation," and is the one that deals with that subject, and the instances there referred to are those which have been mentioned—the Columbus and Hocking Coal and Iron Pool, the Rock Island episode, and the California Petroleum Company matter (Pujo R., pp. 46–52). This shifting of his position at the last moment does not help his case as it is so clearly an effort to bolster it up by bringing to its support charts, tables and transactions that do not at all bear upon manipulation. The same is true of his bringing in the dealings in the stock of the Amalgamated Copper Company shown in one of the tables and charts, and now amplified by the charge that the price of copper metal in 1906 and 1907 was manipulated by the United Metals Selling Company in aid of the manipulation of the stock of the Company which Mr. Wolfson's statement shows to be entirely without substance. As we have shown (R., pp. 532–534) these charts and tables and the transactions in the stocks of the companies mentioned to which they refer show speculation and nothing else; not "unwholesome" speculation, but

speculation in its ordinary and accepted sense; and Mr. Untermyer distinctly says in his brief that "*this bill is not intended to prohibit speculation*" (R., p. 629). All that Mr. Untermyer says in his argument and brief about the prevalence of manipulation on the Exchange is untrue with respect to recent times, and grossly exaggerated as to any time.

(2) Mr. Untermyer says in his brief of the attitude of the Exchange towards manipulation (R., p. 640):

> "Manipulation is considered legitimate provided commissions are paid at both ends of the manipulated transaction."

No statement could be more unfounded. That is not and never has been the attitude of the Exchange. It is no more true to say that it has been than to say, as he does, that "wash sales" and "matched orders" have been regarded as "legitimate until *recent* years" (R., p. 618), when the fact is that they have been prohibited by the constitution of the Exchange for over fifty years.

The true attitude of the Exchange towards manipulation is set forth in our brief (R., pp. 534–537), and need not be repeated here. For Mr. Untermyer to say that the persistent attitude of the Exchange has been to defend, retain and encourage manipulation is disproved by the measures taken to prevent it, also set forth in detail in our brief (R., pp. 544–547), down to the last rules denouncing every transaction that does not involve an actual change of ownership of the securities bought and sold, and which provide for a Committee to watch the daily transactions of the Exchange to detect irregular, improper or manipulated transactions.

XIII.

Incorporation.

Mr. Untermyer devotes a great deal of space to what purports to be a discussion of the necessity of the incorporation of the Exchange, but which is really a discussion of all sorts of matters that have no relation whatsoever to the subject. The one fundamental point for him to meet he avoids. That point is, that every requirement of this bill and every mode of regulation that has been suggested by him or any one can be applied to an unincorporated exchange as well as to one that is incorporated, and therefore incorporation is not essential to any form of regulation. This is the point that we urged and elaborated before the Legislature of the State of New York when incorporation was sought there and denied, and which has been urged and elaborated before this Committee, and Mr. Untermyer does not venture to answer it. Failing to do so his whole case for incorporation falls to the ground.

XIV.

Conclusion.

There are many other points in the argument and brief of Mr. Untermyer that I am tempted to answer, but to do so would unduly extend this reply. They are just as vulnerable as those that have been noticed. The purpose of this reply has not been one of antagonism, but to induce careful scrutiny of Mr. Untermyer's criticisms and denunciations of the Exchange. That scrutiny the Exchange asks, and it is content to be judged by its results.

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END OF
TITLE